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CHARITABLE DEDUCTIONS FOR RAIL-TRAIL CONVERSIONS: RECONCILING THE PARTIAL INTEREST RULE AND THE NATIONAL TRAILS SYSTEM ACT

SCOTT ANDREW BOWMAN*
DANAYA C. WRIGHT**

ABSTRACT

This Article examines an undeveloped legal topic at the intersection of tax law and real property law: charitable deductions from income tax liability for donations of railroad corridors that are to be converted into recreational trails. The very popular rails-to-trails program assists in the conversion of abandoned railroad corridors into hiking and biking trails. However, the legal questions surrounding the property rights of these corridors have been complex and highly litigated. In 1983, Congress amended the National Trails System Act to provide a mechanism for facilitating these conversions, a process called railbanking. In essence, a railroad transfers its real property interests in its corridor to a trail sponsor for interim trail use and retains a right to re-enter in the event that rail service needs to be reactivated on the line. Thus, the dual purposes of the statute—interim trail use and rail preservation—are furthered by a process that prevents the corridor from being broken up and irrevocably lost.

An important element of railbanking and trail conversion is the prospect for the railroads of a deduction from their income tax liability when they donate these corridors for public trail use. Recently, however, the Internal Revenue Service (“IRS”) has begun to question the donations by invoking the so-called “partial interest rule.” Should the IRS prevail in applying this rule, the deduction would be entirely disallowed under current Internal Revenue Code provisions.

This Article discusses the interaction of these two areas of law and proposes ways the railroads can draft their trail use agreements to minimize the likelihood of being challenged by the IRS, and ways the IRS, the

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Surface Transportation Board, Congress, and the railroads can work together to reconcile the conflict in these different laws. In the end, we believe that the rail preservation function is critical to the public welfare and that it is in everyone's best interest to further railbanking and interim trail use. However, doing so requires careful drafting and perhaps regulatory changes to ensure that railroads do not unfairly take advantage of the tax system, while at the same time maintaining an incentive for railroads to railbank and offer their corridors for future public use.

INTRODUCTION

Rail-trail conversions have become an increasingly popular way to recycle dormant rail corridors, as public recreational use of the corridors for activities such as hiking and biking has become widespread.¹ Aside from avoiding the potential tort liability associated with vacant rail corridors, a major incentive for railroads to convert the corridors into publicly used trails is the possibility of a large charitable deduction from federal income tax that may result from the conversion. The requirements of the federal railbanking statutes, coupled with the complexity of the Internal Revenue Code ("I.R.C.") provisions on charitable deductions, however, has presented a serious obstacle for railroads that want to claim the deduction. In order to convert the corridor to a trail through the federal railbanking program, a railroad must retain a right to re-enter in case national transportation needs demand reactivation of rail services.² That right to re-enter, which is a future interest sliced out of the railroad's property interests in its corridor land,³ means that the property interests the railroad transfers to a trail group are less than the totality of property

¹ See, e.g., Michael Rowe, *Rails and Trails: An Idea Whose Time Has Come*, AMERICANTRAILS.ORG, Dec. 2000, <http://www.americantrails.org/resources/railtrails/RailsAndTrailsMike.html> ("As of March, 1992, there are already some 5,000 miles of rail-trails . . .").

² 49 C.F.R. § 1152.29(a)(3) (2007).

³ There is disagreement over the nature of this property right, and whether it is even a property right at all. It could be a contractual right or a regulatory right, and no court has weighed in on the matter. If it is not a property right at all, the issues raised in this article are moot, though, for the reasons expressed below, we think that is a narrow way to view this interest. Moreover, to the extent courts determine it to be a property right, the conflicts between trail groups and railroads, which might arise in only a small number of cases, will force the parties to deal with the partial interest rule. By taking on that possibility, we hope to anticipate and provide a way to resolve the conflicts that ultimately protects the interests of all parties. See *infra* Part IV for further discussion of this issue.

it holds. Ironically, retaining this right potentially nullifies a railroad's claim to a charitable deduction by violating the partial interest rule of I.R.C. § 170(f)(3)(A). Without the deduction, the incentive to preserve rail corridors for future uses may disappear, undermining national transportation policy and a number of federal statutes designed to promote rail-trail conversions.

This Article explores the confluence of property and tax law in this relatively undeveloped area of law. After explaining the legal mechanism of railbanking and trail conversion, we discuss the tension between the National Trails System Act ("NTSA") and the I.R.C. We explain the partial interest rule and address three potential arguments that railroads have advanced to overcome this obstacle. Only one of these arguments, based upon the so-remote-as-to-be-negligible doctrine, seems to have any likelihood of success. Further, we evaluate strategies that railroads might use to increase their likelihood of prevailing in claims for the deductions. In the end, we propose regulatory and legislative steps towards reconciling the important public policy objectives that the NTSA and the I.R.C. respectively advance.

I. HISTORY OF RAILBANKING AND THE NATIONAL TRAILS SYSTEM ACT

Rail-trail conversions have been occurring for over eighty years, ever since communities began to view discontinued rail corridors as ideal locations for linear parks, greenways, and recreational trails.⁴ As competition from trucking and subsidization of the interstate highway system led to the gradual shrinkage of the national rail network throughout the twentieth century, railroads routinely shed surplus corridors through a haphazard process confusingly called abandonment.⁵ At its peak in 1916, the United States boasted 270,000 miles of railroad track.⁶ However, due

⁴ RICHARD R. POWELL, POWELL ON REAL PROPERTY § 78A.03[2][d] (Michael Allan Wolf ed., LexisNexis Matthew Bender 2007). This chapter was written by co-author Danaya C. Wright, with the research assistance of co-author Scott Andrew Bowman.

⁵ *Id.* §§ 78A.03[2][b]-[c], 78A.10[1]-[2]. The term abandonment is particularly confusing because it is the process used by the Surface Transportation Board ("STB") to determine if a railroad may discontinue services and be removed from the active rail network. Once STB abandonment is complete, federal jurisdiction over the real property of the roadbed disappears. *Id.* § 78A.10[1]. Also, states use the term abandonment when referring to the railroads' relinquishment of rights in their real property easements, which causes termination and the unburdening of the servient estate. *See id.* § 78A.10[2][c].

⁶ Andrea Ferster, *Rails to Trails Conversions: A Review of Legal Issues*, PLANNING & ENVT'L. L., Sept. 2006, at 3.

to the reduction and consolidation of rail services, a little over 100,000 miles remain in active use.⁷ Many discontinued corridors have been permanently broken up, passing into the ownership of adjacent landowners through a variety of legal mechanisms.⁸ Some parcels were sold outright by the railroads to adjacent landowners.⁹ Other parcels, particularly those held only as easements, simply terminated and the underlying servient estate became unburdened.¹⁰ The physical land was often reabsorbed into the land from which it came. Some states adopted presumptions that abandoned corridors merge back into adjacent land unless someone else can prove better title to the corridor.¹¹ Other corridors were converted to roads or canals, or were transferred to state and local governments for public purposes.¹² Less than five percent have been sold intact and converted to recreational trails.¹³

⁷ RAILS-TO-TRAILS CONSERVANCY, UNDERSTANDING ENVIRONMENTAL CONTAMINANTS: LESSONS LEARNED AND GUIDANCE TO KEEP YOUR RAIL-TRAIL PROJECT ON TRACK 5 (2004) [hereinafter UNDERSTANDING ENVIRONMENTAL CONTAMINANTS], available at http://www.railtrails.org/resources/documents/resource_docs/EPAReport.pdf.

⁸ Ferster, *supra* note 6, at 4.

⁹ See *id.*

¹⁰ Danaya C. Wright & Jeffrey M. Hester, *Pipes, Wires, and Bicycles: Rails-to-Trails, Utility Licenses, and the Shifting Scope of Railroad Easements from the Nineteenth to the Twenty-First Centuries*, 27 *ECOLOGY L.Q.* 351, 434 (2000).

¹¹ POWELL, *supra* note 4, § 78A.08[5]; see also *Fambro v. Davis*, 348 S.E.2d 882, 884 (Ga. 1986) ("Whenever a railroad is abandoned, the presumption is that the fee is in the adjacent landowners and that their right extends to the center line, unless the contrary appears."); *Mobile, J. & K.C.R. Co. v. Kamper*, 41 So. 513, 514 (Miss. 1906) ("It only remains for us to say that the appellee should be allowed to recover such part of the land conveyed as is shown to have been abandoned by appellant . . ."); *Boyles v. Mo. Friends of the Wabash Trace Nature Trail, Inc.*, 981 S.W.2d 644, 648 (Mo. Ct. App. 1998) ("When use of an easement for railroad purposes ceases, title to the fee is presumed to be in the abutting land owners . . . in the absence of contrary evidence . . ."); *Dellach v. DeNinno*, 2004 PA Super. Ct. 428, ¶ 7, 862 A.2d 117, 118 ("When a railroad abandons an easement, the right-of-way is extinguished and the land is owned in fee simple by the owner or owners of the land on either side of the right of way."); *McLemore v. Memphis & C. R.R. Co.*, 69 S.W. 338, 342 (Tenn. 1902) ("We cannot construe the language of the deed to convey anything more than an easement over the mortgaged lands to the railroad company, which was subject to be defeated by abandonment or voluntary surrender to the owner."); *Wheeling Stamping Co. v. Warwood Land Co.*, 412 S.E.2d 253, 257 (W. Va. 1991).

¹² POWELL, *supra* note 4, § 78A.14; see also N.Y. TRANSP. LAW § 18 (McKinney 1994) (giving the New York Department of Transportation a preferential right to acquire abandoned railroad corridors for conversion to other public uses); *Faux v. City of L.A.*, 432 P.2d 849, 856 (Cal. 1967) (city converted portions of rights of way into public streets); Wright & Hester, *supra* note 10, at 441-53, 56; Jeffrey M. Heftman, Note, *Railroad Right-of-Way Easements, Utility Apportionments, and Shifting Technological Realities*, 202 U. ILL. L. REV. 1401 (2002).

¹³ Of the more than 100,000 miles of railroad corridor that has been lost since the 1920s,

By 1980, however, federal officials had become concerned that too many miles of transportation corridor were being lost through what could only be described as neglect and indifference.¹⁴ Little-used corridors became breeding grounds for homeless vagrants, illegal landfills, or motocross or snowmobile routes. Despite posting no-trespassing signs, railroads could not effectively police their unused or little-used corridors. Consequently, if a railroad was certain that it was not going to reactivate services on a particular line and wanted to be free of liability for injuries to trespassers, it would generally offer the corridor land for sale at auction. Adjacent landowners would purchase pieces adjacent to their lots, municipal governments would purchase valuable portions running through their commercial and industrial districts, or adjacent businesses would purchase portions in order to protect pre-existing easements or access across the tracks to highways, shipping ports, grain silos, or other services. Even state highway departments might acquire a discontinued corridor for conversion or expansion of highway needs.

As rapid residential development during the 1970s occurred, often without proper attention to the provision of adequate parks, many communities and recreational user groups identified abandoned railroad corridors as ideal locations for linear parks, recreational trails, or urban pedestrian zones.¹⁵ As Americans became more interested in fitness, the jogging and bicycle trails that would keep users away from vehicular traffic began attracting significant numbers of users.¹⁶ Thus, rails-to-trails was born.¹⁷

less than 5,000 have been railbanked under the federal railbanking law. *See* Ferster, *supra* note 6, at 3. An additional 9,000 miles have been converted to trails under other mechanisms. *See* Rails-To-Trails Conservancy, About Rails-to-Trails Conservancy, <http://www.railtrails.org/whowere/index.html> (last visited Mar. 25, 2008) (stating that nearly 14,000 total miles of rails have been converted to trails).

¹⁴ *See* Rails-To-Trails Conservancy, Railbanking: History of Railbanking, http://www.railstotrails.org/whatwedo/trailbuilding/technicalassistance/toolbox/20070906_railbanking_history.html (last visited Mar. 25, 2008).

¹⁵ *See* POWELL, *supra* note 4, § 78A.03[2][d]; Peter Harnik, The History of the Rail-Trail Movement, <http://www.railtrails.org/whatwedo/railtrailinfo/history.html> (last visited Mar. 25, 2008).

¹⁶ *See* Harnik, *supra* note 15 (“[R]ail-trails have begun to make a significant mark, with . . . over 100 million users per year.”).

¹⁷ *Id.* Although corridors had been converted before the 1980s, the creation of the Rails-to-Trails Conservancy (“RTC”) dramatically improved the odds that a corridor would be converted. By providing financial support, quick notice of potential railroad abandonments, and legal and technical assistance, RTC has helped hundreds of governmental entities and trails groups with rails-to-trails conversions. For further information on RTC and its history, see Rails-to-Trails Conservancy, About Rails to Trails Conservancy, <http://www.railtrails.org/whowere.index.html> (last visited Mar. 25, 2008).

A small group of environmentalists, bicyclists, lawyers, and alternative transportation advocates devised an ingenious way to preserve rail corridors for possible future rail use while allowing for interim recreational trails. That mechanism is called railbanking, and it was adopted by Congress in 1983 through amendments to the 1967 National Trails System Act.¹⁸ Railbanking occurs when a railroad, seeking authorization from the Surface Transportation Board ("STB") to discontinue rail services and abandon a corridor,¹⁹ negotiates with a trail group for interim trail use, and the STB issues a railbanking order, either following a Notice of Interim Trail Use ("NITU") or a Certificate of Interim Trail Use ("CITU"), preserving the corridor for future rail use and allowing interim trail use.²⁰

The 1983 NTSA amendment, codified at 16 U.S.C. § 1247(d), provides that all property rights of a railroad will remain intact during the period of railbanking and interim trail use, on the ground that the corridor is being preserved for potential future rail use.²¹ Clearly, if a railroad owns

¹⁸ National Trails System Act Amendments of 1983, Pub. L. No. 98-11, sec. 208, § 8, 97 Stat. 42, 48 (codified as amended at 16 U.S.C. § 1247(d) (2000)). For the legislative history of the 1983 Act, see H.R. REP. NO. 98-28 (1983), *as reprinted in* 1983 U.S.C.C.A.N. 112; S. REP. NO. 98-1 (1983).

¹⁹ The Interstate Commerce Commission ("ICC"), established in 1887, originally had jurisdiction over interstate railroad services and railroad abandonments after 1920. However, the ICC was abolished in 1995 and replaced by the STB, under the Department of Transportation. See ICC Termination Act of 1995, Pub. L. No. 104-88, § 201, 109 Stat. 803, 932; POWELL, *supra* note 4, § 78A.03[2][b]-[c]. For most purposes, the authority of the ICC and the STB are the same and the acronyms are used interchangeably, depending on the date of the agency actions.

²⁰ 49 C.F.R. § 1152.29 (2007).

Railbanking is a process by which the railroad negotiates with a qualified trail manager to assume financial and legal responsibility for the corridor during interim trail use and to hold all property rights intact for potential future rail reactivation. If a qualified trail group requests time to negotiate with the railroad before the issuance of the final certificate of abandonment, then a . . . NITU or . . . CITU will issue, allowing 180 days for negotiating with a trail group for conversion to a recreational trail. If the negotiations are successful, the STB will issue a railbanking order.

POWELL, *supra* note 4, § 78A.10[1] (citations omitted). "NITUs and CITUs are issued during the negotiation process to allow for the sale or transfer of a rail corridor to a qualified trail group." *Id.* at n.11 (citing 49 C.F.R. § 1152.29).

²¹ The exact language states:

The Secretary of Transportation, the Chairman of the Surface Transportation Board, and the Secretary of the Interior, in administering the Railroad Revitalization and Regulatory Reform Act of 1976 [45 U.S.C.A. § 801 et seq.], shall encourage State and local agencies and private

its corridor land in fee simple absolute, the change in use from railroads to trails will not terminate the railroad's property rights.²² But if a railroad owns only a defeasible fee interest, which terminates upon discontinuation of railroad services, those parcels might revert to the original grantor of the land if the corridor is converted to a trail.²³ Similarly, if the railroad owns only an easement for railroad use, discontinuation of railroad services and sale of the corridor might cause the easements to be extinguished under state law.²⁴ But under the railbanking statute, these lesser interests remain intact during the interim trail use period and do not terminate.²⁵ Because most railroad corridor land was acquired in the nineteenth century through any number of different methods (private sale, private donation, eminent domain, prescription, or government grant), most corridors consist of parcels owned in a variety of different interests: some in fee simple absolute, some in fee simple determinable, and others in easement.²⁶ A small corridor as short as a mile might have been acquired through dozens of different transactions and be held in any combination of these interests.

One of the most fragile property interests a railroad can hold is an easement, often defined under state law as being a right to use the

interests to establish appropriate trails using the provisions of such programs. Consistent with the purposes of that Act, and in furtherance of the national policy to preserve established railroad rights-of-way for future reactivation of rail service, to protect rail transportation corridors, and to encourage energy efficient transportation use, in the case of interim use of any established railroad rights-of-way pursuant to donation, transfer, lease, sale, or otherwise in a manner consistent with the National Trails System Act . . . , if such interim use is subject to restoration or reconstruction for railroad purposes, such interim use shall not be treated, for purposes of any law or rule of law, as an abandonment of the use of such rights-of-way for railroad purposes.

16 U.S.C. § 1247(d).

²² See *King County v. Rasmussen*, 299 F.3d 1077, 1088 (9th Cir. 2002); *Miller v. United States*, 67 Fed. Cl. 542, 544 (2005); *Dep't of Conservation ex rel. People v. Fairless*, 653 N.E.2d 446, 453 (Ill. App. Ct. 1995).

²³ POWELL, *supra* note 4, §78A.10[2][b]. State marketable title acts may also terminate the reversion, effectively converting the railroads' interests to fee simple absolute and extinguishing any future interests that would defeat the railroads' right to railbank. *Id.* §78A.08[1]; see also *Lowers v. United States*, 663 N.W.2d 408, 410 (Iowa 2003); *Severns v. Union Pac. R.R.*, 125 Cal. Rptr. 2d 100, 109 (Ct. App. 2002).

²⁴ See *Preseault v. United States*, 100 F.3d 1525, 1545 (Fed. Cir. 1996); *Glosemeyer v. United States*, 45 Fed. Cl. 771, 777 (2000).

²⁵ 16 U.S.C. § 1247(d).

²⁶ *Wright & Hester*, *supra* note 10, at 376-77.

surface of the corridor land for a particular use: running trains.²⁷ Once rail service ends, the easement might be extinguished under state law, even though mere non-use is not sufficient to terminate an easement.²⁸ In some states, fractionation of the corridor,²⁹ seeking federal abandonment authority,³⁰ or a letter from a railroad ceding all interests in a particular corridor³¹ is sufficient to cause termination of railroad easements. But the railbanking statute specifically holds that these easements will remain valid during an interim trail use period because the corridor is being used for railroad purposes; it is being preserved for possible future rail reactivation.³² A number of courts have recognized that corridor preservation constitutes a legitimate railroad use.³³

Thus, after 1983, a railroad interested in abandoning a line could choose to railbank the corridor if a trail group agreed to assume responsibility for the corridor, use it for interim trail use, and give it back if the railroad needs to reactivate. Railbanking is an attractive option for railroads for numerous reasons. It allows railroads to rid themselves of unwanted corridors through a single transaction to a single buyer. It allows them the right to retake the corridor if they change their minds or subsequently determine that rail service is profitable.³⁴ It allows them to

²⁷ See *Preseault*, 100 F.3d at 1537; *Nat'l Wildlife Fed'n v. ICC*, 850 F.2d 694, 703 (D.C. Cir. 1988); *Toews v. United States*, 53 Fed. Cl. 58, 61 (2002).

²⁸ See, e.g., *Toews*, 53 Fed. Cl. at 61-63. The common law of all states provides that easements are abandoned only through intent to abandon and acts consummating that abandonment. POWELL, *supra* note 4, § 78A.10[2][a]. However, some states have revised their abandonment laws by statute. See *infra* note 30.

²⁹ *Diaz v. Home Fed. Sav. & Loan Ass'n of Elgin*, 786 N.E.2d 1033, 1043 (Ill. App. Ct. 2002); *Buffalo Twp. v. Jones*, 813 A.2d 659, 665 (Pa. 2002); *Saluda Motor Lines, Inc. v. Crouch*, 386 S.E.2d 290, 292 (S.C. Ct. App. 1989).

³⁰ For example, Indiana has provided by statute that obtaining federal abandonment authority, followed by 10 years of nonuse, constitutes abandonment of state law railroad easements. IND. CODE § 32-23-11-6 (2002).

³¹ See *Mich. Dep't of Natural Res. v. Carmody-Lahti Real Estate, Inc.*, 699 N.W.2d 272 (Mich. 2005); *State v. Hess*, 684 N.W.2d 414 (Minn. 2004). But see *Strong v. Detroit & Mackinac Ry. Co.*, 423 N.W.2d 266, 269 (Mich. Ct. App. 1988) ("We do not believe that the use of the term 'abandoned' in D & M's 1948 notice of claim showed an intent to abandon its property interest in the right-of-way.").

³² 16 U.S.C. § 1247(d) (2000).

³³ See *Preseault v. ICC*, 494 U.S. 1, 19 (1990); *Nat'l Wildlife Fed'n v. ICC*, 850 F.2d 694, 702 (D.C. Cir. 1988); *State by Wash. Wildlife Pres., Inc. v. State*, 329 N.W.2d 543, 547 (Minn. 1983); *Erie Metroparks Bd. of Comm'rs v. Key Trust Co. of Ohio*, 764 N.E.2d 509, 515 (Ohio Ct. App. 2001); *Birdsboro Mun. Auth. v. Reading Co. & Wilmington & N. R.R.*, 2000 PA Super. 231, ¶ 21, 758 A.2d 222, 227 (Pa. Super. Ct. 2000).

³⁴ At least five railbanked corridors have been reactivated. See *BG & CM R.R., Inc., Exemption from 49 U.S.C. Subtitle IV*, Finance Docket No. 34399, 2003 WL 22379168

escape tort liability to trespassers on unused corridors and the environmental liability from a century of heavy industrial railroad use.³⁵ It allows them to retain income from fiber optic, utility, or other incidental uses that they authorized on the corridors while the line was still active.³⁶ It allows them to avoid the liability for demolition of structures or restoration of land.³⁷ It allows them to “green” their image as they advertise their partnerships with conservation and recreational users. And, as we discuss below, it might allow them a federal income tax deduction when they transfer the corridor to a charitable transferee, such as a local government or non-profit trail group.³⁸

Although many rail-trails have been constructed without the benefit of the federal railbanking process, those non-railbanked trails have often been the subject of litigation over the nature of property rights transferred to the trail owner.³⁹ Railroads and trail groups have had to defend each individually deeded or acquired parcel of land comprising the corridor from attacks by adjacent landowners who feel that abandoned corridors should be merged into their own back yards.⁴⁰ And although the

(STB Oct. 17, 2003); Ga. Great S. Div., S.C. Cent. R.R. Co., Inc., Abandonment & Discontinuance Exemption Between Albany & Dawson in Terrell, Lee, & Dawson Counties, Ga., Docket No. AB-389 (Sub-No. 1X), 2003 WL 21132515 (STB May 9, 2003); Mo. Pac. R.R. Co., Abandonment Exemption in St. Louis County, Mo., Docket No. AB-3 (Sub-No. 98X), 1997 WL 201480 (STB Apr. 18, 1997); Norfolk & Western Ry. Co., Abandonment Between St. Marys & Minister in Auglaize County, Ohio, 9 I.C.C.2d 1015 (1993); Iowa Power, Inc., Constr. Exemption in Council Bluffs, Iowa, 8 I.C.C.2d 858 (1990).

³⁵ See *Citizens Against Rails-to-Trails v. STB*, 267 F.3d 1144, 1149 (D.C. Cir. 2001). See generally UNDERSTANDING ENVIRONMENTAL CONTAMINANTS, *supra* note 7, at 8 (detailing how trail developers—rather than railroads—can protect themselves against environmental liability).

³⁶ RAILS-TO-TRAILS CONSERVANCY, FACT SHEET: RAIL-TRAILS & UTILITIES (1997), available at http://www.railtrails.org/resources/documents/resource_docs/tgc_fs_shared.pdf; see also Wright & Hester, *supra* note 10, at 359; Heftman, *supra* note 12, at 1410-11.

³⁷ See, e.g., N.Y. R.R. LAW § 93-b (McKinney 1991) (imposing a post-abandonment demolition obligation for grade crossings and grade-separation structures).

³⁸ See *infra* Part III.A.

³⁹ The issue is whether the railroad’s property rights are sufficiently robust to withstand the transfer to a trail group for a new recreational trail use. See, e.g., *Clark v. CSX Transp., Inc.*, 737 N.E.2d 752 (Ind. Ct. App. 2000); *Maas v. Penn Cent. Corp.*, 2004 OH Ct. App. 7233, 2004 WL 3090396.

⁴⁰ A quick overview of the Preseault litigation shows how avid some landowners are. The Preseaults litigated the issue of ownership of a railroad easement adjacent to their property to the Vermont Supreme Court, the Second Circuit, the U.S. Supreme Court, the U.S. Claims Court, and the Federal Circuit before finally receiving compensation from the Court of Federal Claims. See *Trs. of the Diocese of Vt. v. State*, 296 A.2d 151 (Vt. 1985) (finding lack of subject matter jurisdiction over federal issues); *Preseault v. ICC*, 853 F.2d

constitutionality of the railbanking statute has been challenged on its face, the Supreme Court upheld its constitutionality in 1990 by holding that it is a permissible exercise of Congress's interstate commerce power.⁴¹ The Court left open, however, the question of whether railbanking and interim trail use constitutes a taking of adjacent landowners' property rights. Since that time, dozens of takings challenges have been filed over railbanked corridors.⁴² The Federal Circuit has determined that whether the act constitutes a taking depends on the property rights the railroad

145 (2d Cir. 1988) (affirming the ICC's grant of an exemption to the railroad and upholding the constitutionality of the railbanking statute), *aff'd*, Preseault v. ICC, 494 U.S. 1 (1990); Preseault v. United States, 24 Cl. Ct. 818 (1992) (finding the Preseaults had a property interest under state law but not deciding whether federal law preempted these state property rights); Preseault v. United States, 27 Fed. Cl. 69 (1992) (finding no taking of property under federal law), *rev'd en banc*, Preseault v. United States, 100 F.3d 1525 (Fed. Cir. 1996) (plurality opinion) (finding a property right in the Preseaults and a taking). Following the 1996 Federal Circuit en banc decision, the Court of Federal Claims awarded the Preseaults takings compensation, Preseault v. United States, No. 90-4044L, 2001 U.S. Claims LEXIS 274 (Fed. Cl. May 22, 2001), and attorney's fees, Preseault v. United States, 52 Fed. Cl. 667 (2002). Subsequently, the Preseaults brought 42 U.S.C. § 1983 civil rights actions against the municipality for installing fiber optic cable line across their property without just compensation. The district court granted the city's motion for summary judgment in Preseault v. City of Burlington, No. 02-CV-167, 2004 WL 2732179 (D. Vt. Feb. 5, 2004). On appeal the Second Circuit certified the question of the municipality's rights to lay fiber optic cables to the Vermont Supreme Court in Preseault v. City of Burlington, 412 F.3d 96 (2d Cir. 2005). The Vermont Supreme Court responded that the placement of the utility lines did not unreasonably burden the plaintiffs' land beyond the original intent of the conveyance or condemnation of the right-of-way in Preseault v. City of Burlington, 2006 VT 63, 908 A.2d 419. The Second Circuit, upon receipt of the Vermont Supreme Court decision, held that the city did not violate the takings clause or § 1983. Preseault v. City of Burlington, 464 F.3d 215 (2d Cir. 2006).

⁴¹ Preseault, 494 U.S. at 18.

⁴² For cases finding some liability, see Toews v. United States, 376 F.3d 1371 (Fed. Cir. 2004); Swisher v. United States, 176 F. Supp. 2d 1100 (D. Kan. 2001); Moore v. United States, 63 Fed. Cl. 781 (2005); Hubbert v. United States, 62 Fed. Cl. 73 (2004); Town of Grantwood Vill. v. United States, 55 Fed. Cl. 481 (2003); Preseault, 2001 U.S. Claims LEXIS 274; Glosemeyer v. United States, 45 Fed. Cl. 771 (2000). For a case finding no liability, see Chevy Chase Land Co. v. United States, 37 Fed. Cl. 545 (1997), *aff'd*, 230 F.3d 1375 (Fed. Cir. 1999). For cases dismissed on statute of limitation grounds, see Barclay v. United States, 351 F. Supp. 2d 1169 (D. Kan. 2004), *aff'd*, 443 F.3d 1368 (Fed. Cir. 2006); Renewal Body Works v. United States, 64 Fed. Cl. 609 (2005), *aff'd*, Barclay v. United States, 443 F.3d 1368 (Fed. Cir. 2006); Caldwell v. United States, 57 Fed. Cl. 193 (2003), *aff'd*, 391 F.3d 1226 (Fed. Cir. 2004). For other relevant rails-to-trails takings cases, see Hash v. United States, 403 F.3d 1308 (Fed. Cir. 2005); Lowers v. United States, No. 99-cv-90039, 2001 U.S. Dist. LEXIS 23899 (S.D. Iowa May 4, 2001) (discussing class certification); Beres v. United States, 64 Fed. Cl. 403 (2005).

owned and the individual state's laws relating to those rights when rail service is discontinued.⁴³ Some courts have stated that compensation is due to landowners adjacent to parcels held only as easements when, under state law, discontinuation of railroad services would ordinarily constitute termination of the easement.⁴⁴ Other courts have held that compensation is not due to landowners because some state laws permit the conversion of railroad easements to other public transportation uses,⁴⁵ or impose affirmative duties on reversionary interest holders.⁴⁶

Although the legal questions raised by the takings cases have been the subject of the bulk of scholarly commentary on rail-trail conversions,⁴⁷ scholars have also addressed some state law property issues,⁴⁸ the history of railroad property rights,⁴⁹ and the rights of railroads to authorize utility

⁴³ *Toews*, 376 F.3d 1371; *Preseault*, 100 F.3d 1525. The Third Circuit also held that abandonment was a determination to be made under state law. *Lucas v. Twp. of Bethel*, 137 F. App'x 450 (3d Cir. 2005).

⁴⁴ *Toews*, 376 F.3d 1371; *Moore*, 63 Fed. Cl. 781; *Hubbert v. United States*, 58 Fed. Cl. 613 (2003); *Amalixsen v. United States*, 55 Fed. Cl. 167 (2003) (holding that the railroad had a fee simple interest, not an easement); *Glosemeyer*, 45 Fed. Cl. 771.

⁴⁵ See *Chevy Chase Land Co. v. United States*, 733 A.2d 1055 (Md. 1999).

⁴⁶ See *Lowers v. United States*, 663 N.W.2d 408 (Iowa 2003); N.Y. TRANSP. LAW § 18 (McKinney 2008).

⁴⁷ See, e.g., Richard A. Allen, *Does the Rails-to-Trails Act Effect a Taking of Property?*, 31 TRANSP. L.J. 35 (2004); Thomas A. Duda, Comment, *The Use of Discontinued Railroad Rights-of-Way as Recreational Hiking and Biking Trails: Does the National Trails System Act Sanction Takings?*, 33 ST. LOUIS U. L.J. 205 (1988); Danaya C. Wright, *Eminent Domain, Exactions, and Railbanking: Can Recreational Trails Survive the Court's Fifth Amendment Takings Jurisprudence?*, 26 COLUM. J. ENVTL. L. 399 (2001).

⁴⁸ See, e.g., Robin M. Wolpert, *Preserving and Promoting Minnesota's Recreational Trails: State v. Hess*, 31 WM. MITCHELL L. REV. 1133 (2005); Danaya C. Wright, *Trains, Trails, and Property Law: Indiana Law and the Rails-to-Trails Controversy*, 31 IND. L. REV. 753 (1998); Danaya C. Wright, *Private Rights and Public Ways: Property Disputes and Rails-to-Trails in Indiana*, 30 IND. L. REV. 723 (1997); Gregg H. Hirakawa, Note, *Preserving Transportation Corridors for the Future: Another Look at Railroad Deeds in Washington State*, 25 SEATTLE U. L. REV. 481 (2001); Marc A. Sennewald, Note, *The Nexus of Federal and State Law in Railroad Abandonments*, 51 VAND. L. REV. 1399 (1998); Karla Vehrs, Comment, *Minnesota Rails-to-Trails on the Line in State v. Hess*, 89 MINN. L. REV. 1544 (2005); Elizabeth F.R. Gingerich, *Abandonment of Railroad Property: A Guide for Attorneys and Landowners*, RES GESTAE, Oct. 2003, at 24.

⁴⁹ See, e.g., Rita Cain, *Unhappy Trails—Disputed Use of Railroad Rights-of-Way Under the National Trails System Act*, 5 LAND USE & ENVTL. L. 211 (1989); Robin Foster, RLTD Railway Corporation v. Surface Transportation Board: *A Jurisdictional Derailment—Has the Sixth Circuit Thrown the Switch on the Congressional Policy of Promoting "Railbanking," the Conversion of Abandoned Railroad Tracks into Recreational Hiking and Biking Trails?*, 27 N. KY. L. REV. 601 (2000); Charles H. Montange, *Fixing the Unbroken in the Federal Use Statute: A Rejoinder to "Unhappy Trails,"* 6 LAND USE &

and other incidental uses on their corridors.⁵⁰ To date, however, no one has thoroughly studied the newly emerging question of how the railbanking statute should interact with the I.R.C. and its rules on charitable deductions.⁵¹ The dual goals of railbanking—interim trail use and corridor preservation—may conflict if a railroad chooses to re-enter and reactivate services, necessitating removal of the trail. This tension is precisely what can lead to conflicts with the I.R.C. charitable deduction provisions.⁵² This Article charts new territory by examining the ways the I.R.C. and the railbanking statute conflict to frustrate the national transportation goals of the railbanking statute, as well as providing a potential way to harmonize the two areas of law.

To understand the problem, however, one must understand the intricacies of the legal mechanisms at issue. The principal justification for the railbanking statute, and that upon which the entire process depends, is that preservation of the intact corridor constitutes a continuing railroad purpose.⁵³ Preservation is an important public policy because future transportation needs may require use of these unused corridors for rail service, highway service, national defense needs, or whatever transportation needs new technologies may inspire. Key to the preservation purpose is the right of the railroad either to re-enter and reactivate, or to re-enter and transfer the corridor for rail transportation purposes to another railroad, which must be granted to the abandoning railroad by the interim trail manager as part of the railbanking/interim trail use agreement.⁵⁴ Without the right to re-enter the preservation purpose of the corridor would be jeopardized, because the railroad either would have to convince a trail group to sell the corridor back voluntarily, or it would have to exercise eminent domain at prohibitive cost to reacquire the land.

ENVTL. L. 53 (1990); Sheila K. Bryant, Note, *The Constitutionality of Rails-to-Trails Conversions Under the National Trails Act Amendments of 1983*: Preseault v. ICC, 26 TULSA L.J. 295 (1990); Roger M. Stahl, Note, *Smoke Along the Tracks: The Constitutionality of Converting Rails-to-Trails Under 16 U.S.C. § 1247(d)*, 16 WM. MITCHELL L. REV. 861 (1990).

⁵⁰ See, e.g., Wright & Hester, *supra* note 10; Heftman, *supra* note 12; Jill K. Pearson, Note, *Balancing Private Property Rights with Public Interests: Compensating Landowners for the Use of Railroad Corridors for Fiber-Optic Technology*, 84 MINN. L. REV. 1769 (1999).

⁵¹ But see Conrad Teitell, *Railroad Right-of-Way Gift: Deductible?*, N.Y. L.J., Apr. 24, 2006, at 3, whose basic overview provided the foundation for this Article.

⁵² See POWELL, *supra* note 4, § 78A.16.

⁵³ See H.R. REP. NO. 98-28, at 8 (1983).

⁵⁴ POWELL, *supra* note 4, § 78A.11[2]-[3]. 49 C.F.R. § 1152.29(a)(3) and (d)(2) require the interim trail user to acknowledge that the corridor is subject to reactivation.

There is some disagreement over whether this right to re-enter and reactivate is simply a right to reactivate rail service without needing to go before the STB for permission to construct and operate the railroad (i.e., a right that exists solely between the railroad and the STB), or whether it attaches in any way to the property rights in the actual corridor land and is binding on the trail group that now possesses it. Logically, it must be the latter. The right of the railroad to reactivate is a right to reactivate that particular line and is thus tied in some way to the particular corridor land.⁵⁵ Also, the trail groups that acquire deeds to the corridor land do so subject to the railroad's rights to reactivate.⁵⁶ Even deeds that do not expressly include a right to re-enter or a power of termination are given "pursuant to 16 U.S.C. § 1247(d)," which establishes the framework for permitting interim trail use while corridor conservation continues.⁵⁷ The entire purpose of the railbanking statute would be frustrated if the railroad did not have a property right to reacquire the corridor land, because then a trail group could either sell parcels of the land for non-trail purposes and break up the corridor, or it could call to its defense state trespass law if the railroad attempted to re-enter.⁵⁸ Either of these actions would frustrate the corridor conservation purposes of the statute.

Furthermore, even if the limitations on subdivision and sale imposed on the trail group inure to the government or the STB, the railroad would be entitled to have its rights restored to it upon STB approval of reactivation. This is not to say that the railroad is entitled to reacquire the corridor land at any time and at no cost; certainly, conditions may be

⁵⁵ The STB requires that in the contract of sale between the railroad and an interim trail user (and it is notably an "interim" user), the trail user must acknowledge the railroad's right to reactivate if it so desires. 49 C.F.R. § 1152.29(a)(3) (requiring the interim trail user to acknowledge that "use of the right-of-way is subject to . . . possible future reconstruction and reactivation of the right-of-way for rail service").

⁵⁶ See 16 U.S.C. § 1247(d) (2000).

⁵⁷ *Smith v. Palmetto Conservation Found.*, CA No. 8:03-1587-20, slip. op. (D.S.C. 2004). In finding that a deed and contract that merely reference the Trails Act are sufficient to constitute an interim trail use agreement, the court stated that "[t]he possibility of restoration of rail service is the essence of any agreement made subsequent to the issuance of a NITU and need not be expressly indicated." *Id.* at *5.

⁵⁸ If a railroad did not have a property right to reacquire and reactivate, and it simply alerted the trail manager that it was going to reactivate rail services and started rebuilding trackage on the trail, the trail manager would surely file suit for an injunction claiming trespass under state law. Whether any court would honor the state trespass law over the federal railbanking law in light of the deeds and agreements that acknowledge the railroad's rights to reactivate has not been litigated, but we believe no court would do so.

imposed by deed or by law on the railroad's exercise of its right to re-enter. Some trail use agreements require that the railroad compensate the trail group by reimbursing it for the costs of improvements or by paying fair market value. Provisions like this make the railroads' rights look like options to purchase, but these options are still property rights that inhere in the railroads. Random third parties do not have the right to force a trail group into court to negotiate a fair price if the trail group is unwilling to sell: the railroad does. And even when the deeds are silent on the terms or conditions of reacquisition, the railroads certainly have the power to bring the trail group to the bargaining table.

At most times the interests of the railroads and the trail groups converge when the corridor is railbanked and used for interim trail use. However, there are those instances when a railroad wants to reactivate, and the trail group opposes it, that their interests diverge. Although this has not occurred often, it can be a bitter and expensive process if the parties do not understand the rights that each possesses. If a railroad has the right to operate rail service by virtue of the railbanking agreement but no authority to compel restoration of the corridor, the railbanking statute would be rendered virtually meaningless, so much so that the vital function of holding easements and defeasible fee interests in abeyance would be undermined. If the railroad has the right to re-enter without any concern for the trail group, however, the interim trail use function would be frustrated, and fundamental equity rights would be trampled. Thus, when the interests of railroads and trails groups diverge during reactivation, it is important that courts take into account the dual purposes of the federal statute and attempt to devise a solution that serves both ends.⁵⁹ Imposing an obligation on the railroad to pay fair market value or to reimburse the cost of improvements to a trail group serves equitable ends and goes a long way toward ameliorating the negative effects of the partial interest rule.⁶⁰

This right to reactivate, whether it is a right to re-enter, a power of termination, a pre-emptive right, an option to purchase, or some similar property right, is a contingent future interest that is carved out of the railroad's property rights in the corridor and retained when it transfers the present possessory estate to the interim trail user. Consequently, when the railroad transfers less than the full panoply of property rights it owns by entering into an interim trail use/railbanking agreement, it

⁵⁹ See *infra* Part III.C.3.

⁶⁰ See *infra* Part IV.

potentially runs afoul of the I.R.C. rules on charitable deductions. To the extent the I.R.C. requires the transfer of all of a railroad's property rights in order to qualify for the deduction, the denial of the deduction may be enough to discourage a railroad from railbanking and allowing conversion to trail use. Such a consequence would impede the important national public policy of preserving intact rail corridors. In fact, it would erode a major application of 16 U.S.C. § 1246(k), which is designed to facilitate charitable deductions for contributions of land to the National Trails System.⁶¹ While railroads are faced with the challenge of successfully navigating a quagmire of complex tax provisions, further administrative and legislative measures may be necessary to ensure that the I.R.C. provisions do not swallow the policy objectives of the NTSA.

II. THE PARTIAL INTEREST RULE

A. *The Creation of the Partial Interest Rule*

I.R.C. § 170 generally allows a taxpayer to deduct the amount of any charitable contribution that the taxpayer makes during the taxable year.⁶² A charitable contribution is rather broadly defined under the I.R.C. and includes donations made to a non-profit organization for religious, charitable, scientific, literary, or educational purposes, and donations made to a state or local government if made for exclusively public purposes.⁶³ These seemingly generous provisions, however, are conditioned and eroded by other provisions of § 170.

Notable among these is the partial interest rule set forth in § 170(f)(3)(A). This rule provides that a taxpayer is not entitled to any charitable deduction if the taxpayer contributes less than the taxpayer's entire interest in transferred property.⁶⁴ The partial interest rule was created as part of an amendment to § 170 under the Tax Reform Act of 1969.⁶⁵ It was designed to help eliminate perceived abuses of the charitable deduction by taxpayers who donated income interests, remainder

⁶¹ *Id.*; see also 16 U.S.C. § 1246(k) (2000).

⁶² I.R.C. § 170(a)(1). Unless otherwise noted, all references to the Internal Revenue Code and Treasury Regulations refer to the statute or regulation currently in force as of the date of this Article.

⁶³ *Id.* § 170(c).

⁶⁴ *Id.* § 170(f)(3)(A).

⁶⁵ Tax Reform Act of 1969, Pub. L. No. 91-172, § 201(a)(1), 83 Stat. 549, 549-58.

interests, or other partial gifts to charity.⁶⁶ The amendment to § 170(f)(3)(A) was especially tailored to eliminate charitable deductions in cases where the taxpayer permitted the charity to use the property for only a period of time.⁶⁷ Denying a deduction for mere use prevents what was seen as, in essence, a double benefit for the taxpayer: the taxpayer reduced actual gross income by foregoing the income that the asset could have produced if not used by the charity, and the taxpayer also received a deduction in calculating taxable income for the same foregone income that the asset would have produced.⁶⁸ In this sense, the foregone income was subtracted twice. This prohibition on deductions for charitable use remains the law today.⁶⁹ Thus, where a donor retains a remainder or reversionary interest, in most instances the partial interest rule denies the donor a charitable deduction, unless the retained interest is held in trust subject to very specific requirements.⁷⁰

These amendments were important steps to eliminate abuse, particularly where non-income-producing assets were at issue, and to promote the important policy underlying the charitable deduction by ensuring that only *bona fide* contributions are permitted. Yet the application of the partial interest rule sweeps broadly, yielding potentially inequitable

⁶⁶ Thomas R. Moore, *Estate Planning Under the Tax Reform Act of 1969: The Uses of Charity*, 56 VA. L. REV. 565, 570-74 (1970) (discussing the goals of the Tax Reform Act of 1969).

⁶⁷ *Id.* at 573-74 n.51.

⁶⁸ For example, consider a taxpayer who owns rental property, the entire rental value of which is \$100,000. Under the law prior to the amendment, if the taxpayer permitted the charity to use 10% of the property, its \$100,000 income would be reduced \$10,000 by the foregone income and an additional \$10,000 by the value of the property the charity used. *Id.*; Arthur B. Custy & David A. Solberg, *Charitable Contributions Deduction Under the Tax Reform Act of 1969*, 7 WILLAMETTE L.J. 207, 217-19 (1971); see also *Threlfall v. United States*, 302 F. Supp. 1114, 1116-18 (W.D. Wis. 1969); *Passailaigue v. United States*, 224 F. Supp. 682, 683-84, 687 (M.D. Ga. 1963).

⁶⁹ See *Logan v. Comm'r*, 68 T.C.M. (CCH) 658-59 (1994) (denying taxpayer a charitable deduction for storing county fire engine in garage); *Stjernholm v. Comm'r*, 58 T.C.M. (CCH) 389, 390-92 (1989), *aff'd*, 933 F.2d 1019 (10th Cir. 1991) (denying taxpayer deduction for permitting charity to use a specialized vehicle for medical services).

⁷⁰ Note that where the trust grantor retains a remainder interest and the charity is permitted to use the property, the charity in essence receives the income interest from the trust. Following the 1969 amendments and under present law, the income interest must be either in the form of a guaranteed annuity or a fixed percentage of the trust corpus to be distributed no less than annually to the charity. I.R.C. § 170(f)(2)(B). Charitable remainder interests must also meet certain requirements. See *id.* § 644 (specifying charitable remainder trust requirements); *id.* § 642(c)(5) (regarding pooled income fund requirements).

results. This is particularly so because the rule is an all-or-nothing one; if the taxpayer falls into the partial interest trap, the deduction is disallowed in its entirety.⁷¹ For this reason, the IRS and the courts have recognized two major exceptions to § 170(f)(3)(A): the insubstantiality rule and the so-remote-as-to-be-negligible doctrine.

B. *The Insubstantiality Rule*

The insubstantiality rule is derived from Treasury Regulation § 1.170A-7(b)(1)(i) and provides that when a taxpayer retains only an insubstantial interest in the contributed property, the taxpayer should not suffer a denial of the charitable deduction.⁷² Accordingly, when the taxpayer successfully demonstrates that the insubstantiality rule applies, the taxpayer is entitled to the entire charitable deduction. The all-or-nothing nature of the partial interest rule requires this more equitable application of the law, and policy reasons support such a rule. Given that the underlying purpose of I.R.C. § 170 is to encourage charitable giving, it would be unreasonable to frustrate a donor's charitable intent by wholly disallowing a deduction where the donor retained only an insignificant interest or subjected the donation to trivial contingencies. Instead, where the retained interest is insubstantial, the practice is to simply disregard the minor retained interest and grant the taxpayer the entire deduction.⁷³

The insubstantiality rule has predominantly been developed by the IRS through a string of revenue rulings that it has issued on the application of Treasury Regulation § 1.170A-7(b)(1)(i). Somewhat problematically, at least for tax lawyers who like certainty in their planning, no bright-line test has emerged to determine whether a retained interest is substantial.⁷⁴ This leaves the application of the rule highly fact dependent

⁷¹ *E.g.*, *Comm'r v. Estate of Sternberger*, 348 U.S. 187, 236 (1955) (holding that the tax code either allows or entirely defeats a taxpayer's claim to a charitable deduction); *United States v. Dean*, 224 F.2d 26, 28-29 (1st Cir. 1995); *Canal Nat'l Bank v. United States*, 258 F. Supp. 626, 633-34, 638 (D. Maine 1966); *Bankers Trust Co. v. United States*, 190 F. Supp. 671, 674 (S.D.N.Y. 1960).

⁷² This rule is not expressly stated in the regulation, but inferred from the requirement that "[a]n undivided portion of a donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest" *Treas. Reg.* § 1.170A-7(b)(1)(i). The inference is that if the interest is insubstantial, the regulation does not apply.

⁷³ See I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006) (citing *Stark v. Comm'r*, 86 T.C. 243, 252-53 (1986)).

⁷⁴ See *infra* notes 77-114.

and potentially amorphous. Moreover, the factual scenarios of the rulings have presented relatively straightforward cases where the substance of the interest is easily classified, with the mere right to train one's dog on the one hand,⁷⁵ versus retained pecuniary interests or incidents of ownership on the other.⁷⁶

Thus, in the first Revenue Ruling on the issue, Revenue Ruling 75-66,⁷⁷ the IRS considered the availability of a charitable deduction for a taxpayer who had contributed land to the United States government and retained the right during his lifetime to train his personal hunting dogs on the property's trails. Additionally, the taxpayer agreed to do so only in accordance with Interior Department regulations.⁷⁸ The fact that the taxpayer's retained right to use the property was personal and terminated upon his death, coupled with the fact that such use was subject to the donee's approval, rendered the retained interest of inconsequential value.⁷⁹ Allowing such a minimal interest to disqualify the deduction is precisely what the insubstantiality rule avoids. The IRS held so much, stating that the taxpayer's retained right was not substantial enough to require the denial of the charitable deduction.⁸⁰

The following year, the IRS began targeting retained interests at the other end of the spectrum—those in which the donor clearly retained a significant interest in the donated asset. Revenue Ruling 76-331⁸¹ presented two examples in which the taxpayers retained pecuniary interests in the donated assets, and the IRS found each interest to be substantial, thus resulting in the complete disallowance of the donors' charitable deductions. First, a corporation donated land to a charitable organization but retained all rights to the minerals, including the right to sell any minerals extracted from the land.⁸² Second, a fifty-year-old individual owned timberland subject to an outstanding sixty-year lease.⁸³ The individual transferred the property to a charitable organization subject to the individual's right to receive all the lease payments during the individual's lifetime.⁸⁴

⁷⁵ Rev. Rul. 75-66, 1975-1 C.B. 85.

⁷⁶ Rev. Rul. 76-331, 1976-2 C.B. 52.

⁷⁷ Rev. Rul. 75-66, 1975-1 C.B. 85.

⁷⁸ *Id.*

⁷⁹ *Id.* at 86.

⁸⁰ *Id.*

⁸¹ Rev. Rul. 76-331, 1976-2 C.B. 52.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

At the individual's death, the charity was to obtain all rights in the land, including the remaining lease income.⁸⁵ The Revenue Ruling recognized the insubstantiality rule, stating that if the donors had retained only insubstantial rights, they would have complied with the requirements of Treasury Regulation § 1.170A-7(b)(1)(i).⁸⁶ However, the right to exploit and sell minerals and the right to lease payments as retained rights in the property were substantial.⁸⁷ The right of the corporation to mine not only reserved a significant pecuniary interest, but also left the corporation with a vested right to disturb the charity's use.⁸⁸ Lease payments by their very nature are a continuing stream of income from the property; over the remaining life expectancy of a fifty-five-year-old, these would aggregate to a sizeable amount. The IRS appropriately held such rights to be substantial.⁸⁹

Similar to cases in which a donor retains a pecuniary interest in the donated assets, the IRS has twice ruled that the retention of incidents of ownership in an asset will be substantial.⁹⁰ An "incident of ownership" is a term of art under the tax code, which is generally used to refer to a

⁸⁵ *Id.* The taxpayer potentially could have avoided the disallowance of the deduction by using a charitable remainder trust. Section 170(f)(3) does not apply to a transfers in trust, and § 170(f)(2) allows a deduction if the trust is a charitable remainder annuity trust or charitable remainder unitrust (under § 664) or a pooled income fund (under § 642(c)(5)). *See* I.R.C. § 170(f)(2)-(3). If the aggregate annual payments under the timber lease would have equaled at least five percent of the property, then the taxpayer likely could have created a qualified charitable remainder trust and received the deduction. *See id.* § 664(d)(2).

⁸⁶ *See* Rev. Rul. 76-331, 1976-2 C.B. 52, 53.

⁸⁷ *See id.* Revenue Ruling 76-331 also distinguishes the factual scenarios it presents from the facts of Revenue Ruling 75-373. In Revenue Ruling 75-373, the IRS found that a taxpayer who donated an easement of fifty feet of beachfront property in gross and in perpetuity to the county was entitled to a charitable deduction. Rev. Rul. 75-373, 1975-2 C.B. 77. The easement allowed the county to operate and maintain the property as a public beach and recreational area. The taxpayer retained mineral rights, the right to access the water, and the use of a channel through the property to adjacent land. The taxpayer also agreed to remain liable for all property taxes, assessments, and levies. *Id.* Although these rights seem substantial, the taxpayer fell within a special provision contained in Treasury Regulation § 1.170A-7(b)(1)(ii), which deems easements in gross and in perpetuity to be an undivided portion of the donor's interest. *Id.* at 78. This provision then triggers the § 170(f)(3)(B)(ii) exception to the § 170(f)(3)(A) partial interest rule. *Id.*

⁸⁸ Rev. Rul. 76-331, 1976-2 C.B. 52, 53.

⁸⁹ *Id.*

⁹⁰ *See* Rev. Rul. 81-282, 1981-2 C.B. 78; Rev. Rul. 76-143, 1976-1 C.B. 63. Note that the IRS has not explicitly used the term "incidents of ownership" in these rulings; however, the rights at issue are certainly incidents of ownership as that term is used in the I.R.C. and Treasury Regulations. *See infra* note 91 and accompanying text.

taxpayer's ability to control the beneficial or fundamental use of an asset, despite the fact that the taxpayer might not have full fee ownership of the asset.⁹¹

One such incident of ownership is the ability to designate a future beneficiary, which the IRS addressed in Revenue Ruling 76-143.⁹² Here, the IRS denied the charitable deduction in two factual scenarios involving the irrevocable assignment of the cash surrender value of a life insurance policy to a charitable organization, subject to the donor's right to designate the beneficiary and assign the policy balance.⁹³ Under the first scenario, the policy was paid-up; under the second, it was not.⁹⁴ In both circumstances, upon the donor's death, the charity would receive an amount equal to the cash surrender value from the proceeds of the policy if the donor died without having surrendered the policy.⁹⁵ Although the charity had a vested and valuable interest in the policy, the donor's ability to change the policy beneficiary was deemed an important property interest.⁹⁶ Indeed, a fundamental incident of ownership of a life insurance policy on one's own life is the ability to control who will receive the benefits upon the owner's death, as the I.R.C. expressly recognizes.⁹⁷ That the

⁹¹ The term "incidents of ownership" is not used in § 170(f)(3), though it does appear later in the subsection. See I.R.C. § 170(f)(10)(D)(i), (E)(i) (providing exceptions for disallowance of deductions in cases of certain annuity contracts and contracts held by charitable remainder trusts). The term is only used in two other sections of the Code. See *id.* § 902(c)(7) (regarding constructive ownership rules in partnerships for purposes of calculating ten percent ownership of foreign corporation voting stock); *id.* § 2042 (providing inclusion in a decedent's gross estate the value of certain life insurance proceeds). The term appears several times in Treasury Regulations. See Treas. Reg. § 1.704-1(e)(iii) (regarding partners' distributive shares in partnerships); Treas. Reg. § 1.465-8(b)(3) (regarding at-risk limitation on deductions); Treas. Reg. § 1.61-22(c)(1) (regarding taxation of split-dollar life insurance arrangements); Treas. Reg. § 25.2503-3(c), ex.6 (regarding definition of taxable gift); Treas. Reg. § 20.2042-1 (regarding proceeds of life insurance); Treas. Reg. § 20.2031-8(a), ex.2-3 (regarding valuation for estate tax purposes of life insurance and annuity contracts).

⁹² Rev. Rul. 76-143, 1976-1 C.B. 63.

⁹³ See *id.*

⁹⁴ See *id.*

⁹⁵ See *id.*

⁹⁶ *Id.*

⁹⁷ See I.R.C. § 2042, which provides for inclusion in a decedent's gross estate the value of the proceeds of any life insurance policy over which the decedent exercised any "incidents of ownership." Notable among the incidents of ownership are "the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, . . . etc." Treas. Reg. § 20.2042-1(c)(2). In this sense, the estate tax provisions treat the right to designate the policy beneficiary as tantamount to full ownership of the policy.

IRS determined the donor's retained rights were substantial, even when the charity had a vested right to the paid-up surrender value of the policy, is not at all surprising.

The IRS also addressed a donor's retention of an incident of ownership in Revenue Ruling 81-282,⁹⁸ relying on its previous holding in the life insurance cases of Revenue Ruling 76-143. In the 1981 Ruling, the IRS considered the application of the insubstantiality rule to a taxpayer who had contributed shares in a corporation to a charitable organization but had retained the right to vote the contributed shares.⁹⁹ Although the voting rights to common stock are not as significant as the pecuniary interests that such shares represent—namely, the ownership of a share of the corporation's assets and the right to a portion of corporate earnings—voting rights are nonetheless a fundamental incident of ownership in common stock.¹⁰⁰ Voting is the manner by which a shareholder exercises control over the corporation and protects the financial benefits of ownership. Thus, despite the fact that the taxpayer had no pecuniary interest in the donated asset, the retained right to vote was deemed a substantial one.¹⁰¹ The IRS accordingly determined that because the right gave the shareholder a voice in the corporation and allowed the shareholder to cast votes affecting the donee's interest in the corporation, the right to vote could not be disregarded.¹⁰² As such, the retention of this substantial right resulted in the disallowance of the taxpayer's deduction.¹⁰³

The revenue rulings demonstrate that the IRS is likely to consider retained pecuniary interests and incidents of ownership to be substantial, but these are only general characterizations of the rulings that alone are not dispositive. This is evident from the only significant judicial application of the insubstantiality rule, which came in 1986 when the Tax Court decided *Stark v. Commissioner*.¹⁰⁴ The taxpayer in *Stark* contributed land

⁹⁸ Rev. Rul. 81-282, 1981-2 C.B. 78.

⁹⁹ *Id.*

¹⁰⁰ *See id.* at 79.

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Stark v. Comm'r*, 86 T.C. 243 (1986). Although *Stark* was the first case to consider the insubstantiality doctrine in reference to charitable deductions, the Third Circuit had previously considered the substantiality of retained rights in commercial transactions to

to the United States Forest Service, but retained a mineral interest in the land and the right to re-enter the land to prospect and mine for a period of twenty-five years.¹⁰⁵ Although this was a pecuniary interest in the property akin to the retained interest in Revenue Ruling 76-331, the right to re-enter was subject to several restraints that limited the time and manner in which the taxpayer could exercise the right, restraints which were absent from the facts in the previous IRS decision.¹⁰⁶ Also of note was the fact that at the time of the conveyance in *Stark* there were no known oil or gas deposits on the property, and the terrain of the land was not conducive to drilling and mining.¹⁰⁷

The Tax Court gave judicial recognition to the insubstantiality rule as articulated by the IRS in Revenue Ruling 75-66 and Revenue Ruling 76-331.¹⁰⁸ According to the *Stark* court, an interest is insubstantial when the taxpayer has, in substance, given away the taxpayer's entire interest in the property; furthermore, the taxpayer must not be able to interfere with the donee's interest.¹⁰⁹ Based upon this understanding of the rule, the court held that the taxpayer's retained interest was insubstantial.¹¹⁰ Even though the donor retained a pecuniary interest in the property, significant restraints upon the donor's right to re-enter the land to mine placed the Forest Service's interest paramount to the donor's.¹¹¹ Furthermore, as there were no known mineral deposits on the land and expert testimony demonstrated that the probability of any deposits was "very negligible,"

determine whether the transfer was a sale or a license. See *E.I. du Pont de Nemours v. United States*, 432 F.2d 1052, 1055-57 (3d Cir. 1970) (considering whether retention of certain rights in transfer of a patent gave rise to capital gain (as a sale) or to ordinary income (as a license)).

¹⁰⁵ See *Stark*, 86 T.C. at 246.

¹⁰⁶ See *id.* at 246-47. Prior to re-entry, the donor or the donor's assignee had to give notice to the Forest Service, demonstrate the authority to re-enter under the agreement, and receive a permit to re-enter. The permit was subject to approval of safety conditions and the payment of a permit fee. Any prospecting or mining of the land could not prevent the full use of the land by the Forest Service, and the donor was bound to repair, replace, and restore the land following any prospecting or mining. *Id.* at 46. In Revenue Ruling 76-331, however, the taxpayer had "the sole right to exploit and sell any minerals" Rev. Rul. 76-331, 1976-2 C.B. 52, 53.

¹⁰⁷ See *Stark*, 86 T.C. at 247.

¹⁰⁸ See *id.* at 251-52.

¹⁰⁹ See *id.* at 252-53.

¹¹⁰ *Id.* at 255.

¹¹¹ See *id.* at 253.

the value of the retained interest was minimal.¹¹² Shortly after the petitioner in *Stark* applied for the deduction, legislation bolstered the notion that the retention of mineral rights is often of *de minimis* value by providing an exception to the partial interest rule when the donor retains an interest only in the property's minerals.¹¹³

Neither the *Stark* decision nor any of the Revenue Rulings provide guidance by delineating factors that will be considered in weighing the significance of a retained interest. And while the only hard-and-fast rule seems to be that the right to walk one's dog on donated property is insubstantial,¹¹⁴ several generalizations are worth restating. First, the ability of the donor to interfere with the donee's use of the property may constitute a substantial right. This is evident from the contrasting facts of Revenue Ruling 76-331 and *Stark*. The fact that the donor in Revenue Ruling 76-331 could re-enter to mine at any time free from the donee's objection made that right much more robust than the narrowly specified circumstances under which the *Stark* donor could re-enter. In this sense the donor in Revenue Ruling 76-331 had a greater ability to interfere with the donee's use and enjoyment of the property. Second, when the donor retains some pecuniary interest in the property, factual inquiry into the actual value of that interest is required. If that value is negligible, as it was in *Stark*, then the insubstantiality rule permits the interest to be disregarded. The converse would seem equally true. Finally, consideration must be given to a donor's continuing ability to exercise control or dominion over the donated property. Retention of any incident of ownership is demonstrative of the fact that the donor has not given away every substantial interest in the property. In this respect, it is important to note that the relevant inquiry is into whether rights incident to ownership exist, not the probability that the donor will exercise those rights. Each of these considerations is useful in determining the substantiality of the rights that railroads retain under the railbanking statute.¹¹⁵

C. *The So-Remote-as-to-be-Negligible Doctrine*

The second exception to the partial interest rule is the so-remote-as-to-be-negligible doctrine. This doctrine is derived from Treasury

¹¹² *Id.* (quoting petitioner's expert witness, Geneos P. Cokinos)

¹¹³ See Pub. L. No. 96-541, § 6, 94 Stat. 3204, 3206 (1980) (codified as amended at I.R.C. § 170(h)); *Stark*, 86 T.C. at 254.

¹¹⁴ See Rev. Rul. 75-66, 1975-1 C.B. 85.

¹¹⁵ See *infra* Part III.B.

Regulations §§ 1.170A-1(e) and 1.170A-7(a)(3).¹¹⁶ As stated in § 1.170A-7(a)(3), the IRS will not deny the deduction

merely because the interest which passes to . . . the charity may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible.¹¹⁷

In the context of the partial interest rule, this means that if there is a minimal probability of the donor's reversionary interest divesting the charitable donee, then the interest will be disregarded. Like the insubstantiality rule, the so-remote-as-to-be-negligible doctrine reflects the public policy consideration that a taxpayer should not be wholly denied a charitable deduction simply because a highly improbable condition might divest the charitable donee of its interest. Instead, when a taxpayer can demonstrate that a condition attached to a charitable donation is so remote as to be negligible, the IRS will disregard the condition and grant the taxpayer a full deduction.¹¹⁸

The so-remote-as-to-be-negligible doctrine developed through the estate tax regulations, rather than through the income tax code, beginning with the I.R.C. of 1939. It was first considered in *United States v. Dean*,¹¹⁹

¹¹⁶ Both regulations use the phrase "so remote as to be negligible," but do so in different contexts. As used in § 1.170A-1(e), the regulation applies to any transfer that is subject to a condition or power. As used in § 1.170A-7(a)(3), the regulation applies to transfers of less than the taxpayer's entire interest. The distinction is not incredibly important. Section 1.170A-1(e) would apply whenever there is a condition precedent to vesting or a divesting future interest, whereas § 1.170A-7(a)(3) is applied more appropriately only in cases where the interest not transferred to charity functions as a divesting future interest. Accordingly, § 1.170A-7(a)(3) is the appropriate section to apply in the railbanking cases, as the railroads retain a future interest that can potentially divest the charity of its interest in the corridor.

¹¹⁷ Treas. Reg. § 1.170A-7(a)(3). Similarly, § 1.170A-1(e) states that if a gift "is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible." Treas. Reg. § 1.170A-1(e).

¹¹⁸ See Treas. Regs. §§ 1.170A-7(a)(3), 1.170A-1(e). The plain language of both sections read in the context of applying the exemptions supports this proposition.

¹¹⁹ *United States v. Dean*, 224 F.2d 26, 27 (1st Cir. 1955). Other cases had noted the doctrine but had not addressed the precise contours of the doctrine's applicability. See *Comm'r v. Estate of Sternberger*, 348 U.S. 229, 229-30, 233 (1955) (considering the availability of a deduction for a bequest that would vest only if the decedent's wife and twenty-seven-year-old daughter died without living lineal descendants); *Newton Trust*

in which the First Circuit addressed the taxpayer's claim of a charitable deduction under I.R.C. § 812(d) (1939) for a testamentary charitable bequest.¹²⁰ The bequest was to permanently take effect only if the taxpayer's eighty-two-year-old sister predeceased both the taxpayer's sixty-seven-year-old daughter and her sixty-eight-year-old daughter-in-law.¹²¹ Thus, the charitable bequest was subject to the divesting condition of an eighty-two-year-old woman surviving two women fifteen and fourteen years her junior.¹²² Based upon actuarial mortality tables, the taxpayer and the IRS agreed that the probability of the bequest remaining in the charity was ninety-one percent.¹²³

Under the 1939 Code, the relevant provision lay in Treasury Regulation § 105-81.46(a). This regulation provided that conditional charitable bequests were deductible only when the contingency was "so remote as to be negligible."¹²⁴ Yet the First Circuit struggled to reduce to a definite probability the degree to which a contingency must be so remote as to be negligible. The court favorably observed its dicta from *Newton Trust Co. v. Commissioner*, in which it stated that although the probability that one person would survive another of the same age is not so remote as to be negligible, the probability that a ninety-year-old would survive a thirty-year-old could safely be ignored.¹²⁵ The juxtaposition of these two scenarios led the *Newton* court to determine that precisely where on the spectrum particular cases might fall should be done on a case-by-case basis.¹²⁶ In *Dean*, the court found that the nine percent chance of the charitable bequest failing belonged on the *not-so-remote* end of the spectrum, and it denied the deduction.¹²⁷ Despite its desire to evaluate each case on its

Co. v. Comm'r, 160 F.2d 175, 181 (1st Cir. 1947) (holding that a fifty-fifty chance that the charitable bequest would be defeated was not so remote as to be negligible).

¹²⁰ Under the estate tax provisions, a decedent is permitted a deduction for purposes of calculating the net taxable estate for any bequest, legacy, devise, or transfer to a charitable organization. I.R.C. § 2055(a); see also I.R.C. § 812(d) (1939).

¹²¹ *Dean*, 224 F.2d at 27.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ The regulation, in relevant part, provided as follows:

If as of the date of decedent's death the transfer to charity is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that charity will not take is so remote as to be negligible.

Treas. Reg. § 105-81.46(a) (1939).

¹²⁵ *Newton Trust Co. v. Comm'r*, 160 F.2d 175, 181 (1st Cir. 1947).

¹²⁶ See *id.*

¹²⁷ *Dean*, 224 F.2d at 29.

own merits, the court did offer a valuable rule that remains: a contingency that "persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction" would qualify as so remote as to be negligible.¹²⁸

The First Circuit's understanding of the doctrine continued to be applied in cases involving charitable deductions for the estate tax,¹²⁹ yet it was not until 1979 that the Tax Court, in *Briggs v. Commissioner*, applied the doctrine to the income tax.¹³⁰ At issue in *Briggs* was whether the taxpayer was entitled to a charitable deduction for her contribution of land, subject to several conditions subsequent, that she donated to a Native American charitable organization.¹³¹ The taxpayer contributed 184 acres of land to the organization for the purpose of establishing a cultural center, educational center, and medical center, all to benefit Native Americans.¹³² Pursuant to the terms of the gift agreement, the land was granted as a fee simple condition subsequent, with a right to re-enter in the taxpayer upon the failure of certain conditions.¹³³ Notably, the taxpayer had the right to re-enter the land in the event that the organization's board of directors dissolved within seven years of the date of the gift or if the board failed to develop the cultural, educational, and medical centers.¹³⁴ Although the taxpayer donated the property, she did not provide funding for the construction of the centers.¹³⁵ Accordingly, the organization was

¹²⁸ *Id.* The First Circuit was not the first court to test the weight of a contingency upon a hypothetical businessman's judgment. In *United States v. Provident Trust Co.*, the Supreme Court considered the value of a charitable remainder subject to the contingency that a sterile life tenant would have offspring. The Court noted that if the interest had been offered on the open market, "every intelligent bidder" would have ignored the contingency "as utterly destitute of reason." 291 U.S. 272, 286 (1934).

¹²⁹ See *Estate of Woodworth v. Comm'r*, 47 T.C. 193, 198-99 (1966) (holding that contingent bequest in trust for the establishment of a Catholic hospital was not so remote as to be negligible); *State St. Bank & Trust v. United States*, 634 F.2d 5, 11 (1st Cir. 1980); *Bach v. McGinnes*, 333 F.2d 979, 983 (3d Cir. 1964); *Estate of Moffet v. Comm'r*, 269 F.2d 738, 740 (4th Cir. 1959); *Estate of Marine v. Comm'r*, 97 T.C. 368, 384 (1991), *aff'd*, 990 F.2d 136 (4th Cir. 1993).

¹³⁰ *Briggs v. Comm'r*, 72 T.C. 646, 656-57 (1979), *aff'd*, 665 F.2d 1051 (9th Cir. 1981).

¹³¹ *Id.* at 646-48.

¹³² *Id.* at 649.

¹³³ *Id.* at 655.

¹³⁴ *Id.* at 649, 655-56. The court also noted that, under California law, several other requirements in the gift agreement constituted conditions subsequent. These included provisions that prohibited the sale, transfer, or mortgage of the property and the creation of a board of directors on which members would serve for five years, with one Clara Seele as chairman. *Id.*

¹³⁵ *Id.* at 657.

left with the challenge of raising \$4.5 million from private and corporate donations and governmental grants.¹³⁶

As there was no prior case law interpreting the “so remote as to be negligible” language as used in Treasury Regulation § 1.170A-1(e), the court relied on *Dean* and its progeny for guidance.¹³⁷ Because the language used in § 1.170A-1(e) and § 20.2055-2(b) is identical, the court adopted the standard applied in the estate tax cases.¹³⁸ Based upon this test, the court ruled that the possibility of the taxpayer divesting the charity of its interest in the property could not be disregarded.¹³⁹ Because at the time of the donation no financing for the construction of the centers was readily available, there was a good chance that the centers might never be built.¹⁴⁰ This probability was heightened by the fact that few members of the organization had any experience in fund-raising.¹⁴¹ In light of these facts, coupled with dissension and disagreement among the board members, the court found that the possibility that the taxpayer would exercise her right of re-entry was not so remote as to be negligible.¹⁴²

Regarding the income tax charitable deduction, neither the courts nor the IRS has articulated a precise standard for deciding whether a contingency is so remote as to be negligible. Considering the similar language in the estate tax regulations,¹⁴³ however, the IRS has consistently stated that a probability of less than five percent will be disregarded.¹⁴⁴ The five percent rule is also supported by analogy to two estate tax statutes, I.R.C. §§ 2037 and 2042.¹⁴⁵ Section 2037(a)(2) includes in a decedent’s gross estate the value of any property in which the decedent possessed a reversionary interest, but only if the value of the reversionary interest exceeds five percent of the total value of the property.¹⁴⁶ Similarly, § 2042(2)

¹³⁶ *Id.* at 651.

¹³⁷ *Id.* at 656-57. The IRS argued in the alternative that the deduction should be denied under Treasury Regulation § 1.170A-7(a)(3). The court stated that the deduction would be disallowed under either. *Id.* at 659 n.6; *see also supra* note 116.

¹³⁸ *Briggs*, 72 T.C. at 657.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.* at 657-59.

¹⁴³ Compare Treas. Reg. § 20.2055-2(b), with Treas. Reg. § 1.170A-1(e).

¹⁴⁴ See Rev. Rul. 85-23, 1985-1 C.B. 327, 328; Rev. Rul. 78-255, 1978-1 C.B. 294, 294; Rev. Rul. 77-374, 1977-2 C.B. 329, 331; Rev. Rul. 70-452, 1970-2 C.B. 199, 199.

¹⁴⁵ See also Treas. Reg. § 26.2612-1(d)(2)(ii) (using the five percent threshold to determine whether a trust is a skip-person trust for generation-skipping transfer tax purposes).

¹⁴⁶ I.R.C. § 2037(a)(2).

requires inclusion in the gross estate of the value of any life insurance policy in which the decedent possessed a reversionary interest, subject to the same five percent rule.¹⁴⁷ Although there are no binding decisions indicating that a probability of less than five percent will be disregarded for a charitable deduction from income tax, the IRS has recently cited this rule with favor.¹⁴⁸

Should the IRS or the courts extend the five percent rule to § 170(f)(3)(A), then the relevant inquiry turns to a consideration of factors that might be used in reducing the remote contingencies to a probability.¹⁴⁹ This is essentially a question of fact that must be done on a case-by-case basis. In the context of rail-trail deductions, however, the IRS has stated that the probability is to be determined based on four factors.¹⁵⁰ As a recent IRS Technical Advice Memorandum ("TAM")¹⁵¹ states:

The case law looks to specific factors to determine the likelihood of the contribution being defeated: (A) whether the donor and donee intend at the time of the donation to cause the event's occurrence, (B) the incidence of the event's occurring in the past, (C) the extent to which the occurrence of the event would defeat the donation, and (D) whether the taxpayer has control over the event's occurrence.¹⁵²

Although no court has considered these factors expressly, each has been considered, at least in some permutation, in a case or two on point.¹⁵³

¹⁴⁷ *Id.* § 2042(2).

¹⁴⁸ See I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ A TAM is the medium through which the IRS Office of General Counsel communicates its position on contentious points of law to its field agents. Until a case is officially docketed, taxpayer information remains confidential. We interpret the TAM to signify that actual disputes may be forthcoming, but at this time specific audit information (and the grounds of the audit) are confidential.

¹⁵² I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

¹⁵³ The TAM is a bit misleading. In our research, we have found no case law that precisely points to these factors collectively, nor any individual factor expressly stated as such. Several cases make a general inquiry into all facts and circumstances. See *United States v. Dean*, 224 F.2d 26, 28-29 (1st Cir. 1955) (stating that cases must be decided using best judgment of relevant factors); *Hamilton Nat'l Bank of Chattanooga v. United States*, 236 F. Supp. 1005, 1016 (E.D. Tenn. 1965) (admitting all evidence relevant to factual determination); *Bankers Trust Co. v. United States*, 191 F. Supp. 792, 793-94 (S.D.N.Y. 1961) (instructing the jury to consider age, general physical condition, physical capacity to bear

Regardless of the legal authority for these factors, they are certainly relevant and reasonable criteria with which to assess the probability of divestment.

III. CONFRONTING THE PARTIAL INTEREST RULE IN RAIL-TRAIL CONVERSIONS

The availability of charitable deductions for rails-to-trails donations provides a strong incentive for donation and, given the public policies favoring railbanking, permitting the railroads the deduction for the donation of railbanked corridors would seem a logical fit with transportation policy objectives. The IRS's current stance—that the right to re-enter jeopardizes the legitimacy of the deduction—could thwart these public policy goals. The disallowance of the deduction will surely provide a disincentive for railroads to railbank or to donate corridors for interim trail use. Allowing the deduction also entails the risk that railroads will take very large deductions only to exercise their rights of re-entry in the not-too-distant future. Whether such actions would be in good or bad faith is of little concern to the IRS, which is charged with safeguarding the equally important public policy of permitting a charitable deduction only in cases where a taxpayer has made a *bona fide* transfer to a charity in accordance with the letter of the law.¹⁵⁴ Recently the IRS began to question the railroads on this issue. A recent TAM demonstrates the IRS's evaluation of the availability of the deduction.¹⁵⁵ We think this TAM foreshadows a dispute that is likely to arise over the next few years, as the IRS more aggressively challenges

children, statistical evidence, and expert testimony to decide probability of birth by potential mother); *Estate of De Foucaucourt v. Comm'r*, 62 T.C. 485, 493 (1974) (considering facts and circumstance of decedent's health and mental capacity).

Although not expressly stated, each factor does seem to have been considered to some extent in the so-remote-as-to-be-negligible jurisprudence. On factor (A), see *Estate of Harvey v. United States*, 678 F. Supp. 1268, 1273 (E.D. La. 1988). On factor (B), see *Bankers Trust*, 191 F. Supp. at 794-95 (considering past incidents of forty-seven-year-old women giving birth). On factor (C), see *Estate of Greene v. Comm'r*, 11 T.C. 205, 209 (1948) (giving some weight to the fact that exercise of invasion power by trustee in favor of life beneficiary was likely to deplete the corpus). On factor (D), see *Estate of Moffett v. Comm'r*, 269 F.2d 738, 740 (4th Cir. 1959) (recognizing that pure actuarial statistics cannot account for voluntary acts); *Bankers Trust*, 191 F. Supp. at 795 (noting volitional element in decision to conceive); cf. *Stark v. Comm'r*, 86 T.C. 243, 246 (1986); Rev. Rul. 76-331, 1976-2 C.B. 52, 53.

¹⁵⁴ See *supra* notes 65-70 and accompanying text.

¹⁵⁵ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006). See the discussion of TAMs *supra* note 151.

railroads that claim the deduction. In the TAM, the IRS briefly considered three arguments that the railroads ostensibly advanced during IRS examination:¹⁵⁶ a deduction as a matter of law, the insubstantiality rule, and the so-remote-as-to-be-negligible doctrine.¹⁵⁷ The IRS rejected the first two arguments and left the third to further fact finding.¹⁵⁸ We develop and evaluate each argument in turn, noting that although the reasoning in the TAM is generally correct, it is not developed thoroughly enough to lend meaningful guidance to the relevant parties in structuring future railbanking transactions.

A. *Charitable Deduction as a Matter of Law*

First, in what was a rather novel yet misguided argument, the railroads apparently asserted that they were entitled to the deduction as matter of law.¹⁵⁹ The roots of this argument begin in 16 U.S.C. § 1246(k),¹⁶⁰ a section of the National Trails System Act that Congress enacted to promote charitable deductions for donations of land to the national trails system.¹⁶¹ It provides that donors may transfer their property interests "to qualified organizations consistent with section 170(h)(3) of the Internal Revenue Code of 1954."¹⁶² Section 170(h) makes a charitable deduction available for a "qualified conservation contribution," that might otherwise be excluded under the partial interest rule.¹⁶³ Because the partial interest rule would normally disqualify some conservation donations, like conservation easements or donations of development rights, the I.R.C. contains a statutory exception to the partial interest rule for "qualified conservation contribution[s]."¹⁶⁴ The requirements of a qualified conservation contribution are set forth in § 170(h), a rather technical section of the code. In line with its overriding objective of promoting conservation, this provision creates an exception to the partial interest rule for donations to a

¹⁵⁶ The TAM raises three issues and we assume that they represent claims asserted by actual railroads in negotiations or audits with the IRS.

¹⁵⁷ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ National Trails System Act Amendments of 1983, Pub. L. No. 98-11, § 207(i), 92 Stat. 42, 47.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ I.R.C. § 170(h).

¹⁶⁴ *Id.* § 170(f)(3)(B)(iii).

conservation group of a conservation easement or remainder interest in preserved land.¹⁶⁵

With this in mind, a conservation contribution must satisfy three requirements spelled out in § 170(h)(1) to be “qualified” for purposes of § 170(f)(3)(B)(iii).¹⁶⁶ First, the contribution must be “to a qualified organization.”¹⁶⁷ The use of a charitable organization typically makes this the easiest requirement to satisfy. The organization simply must qualify as a charitable organization under § 170(b)(1)(A),¹⁶⁸ which generally includes any organization designed to advance a religious, charitable, humanitarian, scientific, or educational purpose.¹⁶⁹ With this first requirement, railroads would have little problem. As conservation groups or local governments are the interim trail users of choice, the donee is almost always a qualified organization for purposes of § 170(h).¹⁷⁰

The second requirement is that the contribution be made “exclusively for conservation purposes.”¹⁷¹ Section 170(h)(4) recognizes four conservation purposes: the preservation of land for public recreation and education,¹⁷² the protection of natural habitats and wildlife,¹⁷³ the preservation of open space that yields a significant public benefit for scenic enjoyment or pursuant to a governmental conservation policy,¹⁷⁴ and historic preservation.¹⁷⁵ Despite these seemingly clear definitions, whether a contribution is made for a conservation purpose is often a difficult question to resolve and increasingly the subject of litigation between taxpayers and the IRS.¹⁷⁶ Thanks to 16 U.S.C. § 1246(k), however, donations to the

¹⁶⁵ See *id.* § 170(h)(2)-(3).

¹⁶⁶ See *id.* § 170(f)(3)(b)(iii), (h)(1).

¹⁶⁷ *Id.* § 170(h)(1)(B).

¹⁶⁸ *Id.* § 170(h)(3).

¹⁶⁹ *Id.* §§ 170(b)(1)(A), 501(c)(3) (2000).

¹⁷⁰ A qualified trail provider includes any “[s]tate, political subdivision, or qualified private organization.” 16 U.S.C. § 1247(d) (2000); 49 C.F.R. § 115.29(a) (2007). Although there is technically no prohibition on a for-profit organization serving as a qualified trail provider, the donees are almost always charitable or governmental. See Rails-to-Trails Conservancy, TrailDART (Development Assistance Response Team), <http://www.railtrails.org/whatwedo/trailbuilding/technicalassistance/trailDART.html> (last visited Mar. 25, 2008) (reporting fourteen projects on which TrailDART assisted, of which only two included for-profit organizations as clients).

¹⁷¹ I.R.C. § 170(h)(1)(C).

¹⁷² *Id.* § 170(h)(4)(A)(i).

¹⁷³ *Id.* § 170(h)(4)(A)(ii).

¹⁷⁴ *Id.* § 170(h)(4)(A)(iii).

¹⁷⁵ *Id.* § 170(h)(4)(A)(iv).

¹⁷⁶ See *Turner v. Comm’r*, 126 T.C. 299 (2006); *Glass v. Comm’r*, 124 T.C. 258 (2005), *aff’d*, 471 F.3d 698 (6th Cir. 2006); *Ney v. Comm’r* T.C. Summ. Op. 2006-154 (2006); *Strasburg*

national trails system are deemed to satisfy the second requirement.¹⁷⁷ Section 1246(k) essentially functions as a safe harbor for the requirement under I.R.C. § 170(h)(1)(C) and § 170(h)(4) that the contribution be made exclusively for conservation purposes. Section 1246(k) deems donations of property to the National Trails System to “further a Federal conservation policy” and “yield a significant public benefit.”¹⁷⁸ Accordingly, by statute, rail-trail conversions advance a conservation purpose under § 170(h)(4)(A)(iii) by preserving open space for interim trail use.¹⁷⁹ But, there is an obvious discord in this safe harbor provision. Railroads that railbank their corridors with the stated intention of keeping open their options to reactivate seem to operate in a manner contradictory to the conservation goals of the NTSA. The interim trail use may fit the conservation purpose, but reactivating rail services probably does not. In many respects, the provision in § 1246(k) that encourages donations to the trails system is not carefully crafted enough to deal with the rail reactivation justification behind the railbanking statute. This imprecision in the act once again reveals how the dual purpose of the railbanking act—railroad preservation and trail use—conflict in ways that do not provide easy solutions.

The third requirement is that the property interest transferred must be a “qualified real property interest.”¹⁸⁰ If the donor grants its entire interest in the property, a remainder interest, or a restriction in perpetuity on the use of the property, then the contribution will be of a qualified real property interest.¹⁸¹ In this respect, 16 U.S.C. § 1246(k) fails to go far enough for the railroads, as they cannot satisfy the requirement that the donated interest constitute a qualified real property interest. The railroads do not donate remainder interests, nor do they grant perpetual conservation easements. Instead, they grant the present possessory rights and retain a reversionary interest that could be of much longer duration than the present estate. Accordingly, the property interest that the railroads grant does not constitute a qualified conservation contribution.¹⁸² Conservation implies that land will be restricted in the future;¹⁸³

v. Comm'r, 79 T.C.M. (CCH) 1697 (2000); Schwab v. Comm'r, 67 T.C.M. (CCH) 3004 (1994); Satullo v. Comm'r, 66 T.C.M. (CCH) 1697 (1993), *aff'd*, 67 F.3d 314 (11th Cir. 1995); Stotler v. Comm'r, 53 T.C.M. (CCH) 973 (1987).

¹⁷⁷ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

¹⁷⁸ 16 U.S.C. § 1246(k) (2000).

¹⁷⁹ See I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

¹⁸⁰ I.R.C. § 170(h)(1)(A).

¹⁸¹ *Id.* § 170(h)(2).

¹⁸² See I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

¹⁸³ I.R.C. § 170(h)(5)(A) (“A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is *protected in perpetuity*.” (emphasis added)).

railbanking operates to restrict the land now but possibly remove the restrictions in the future. Because the railroads must retain some interest in the railbanked corridors, no railbanked rail-trail conversion can satisfy the narrow requirement of I.R.C. § 170(h)(1)(A).

Nonetheless, it appears from the recent TAM that the railroads might argue, despite the requirements of I.R.C. § 170(h), that 16 U.S.C. § 1246(k) entitles them to a deduction as a matter of law.¹⁸⁴ The IRS has refused this claim in requiring that, irrespective of the language of § 1246(k), rail-trail conversions must satisfy the requirements of I.R.C. § 170 to qualify for a charitable deduction.¹⁸⁵ The IRS dismissed the argument with little discussion, but the issues of statutory construction and legislative intent are worth further consideration.

If pressed on the issue, the IRS would presumably rely on the oft-cited rule that tax deductions, charitable or otherwise, are a matter of legislative grace.¹⁸⁶ The Tax Court has repeatedly interpreted this as a rule of statutory construction, which has been applied to require a narrow construction of tax statutes permitting deductions.¹⁸⁷ This means that the burden rests on the taxpayer to demonstrate that the taxpayer's claim for a deduction falls plainly within the statute that creates the deduction. With the application of this rule of law requiring the railroads to demonstrate that the contribution comes within the statutory provisions of § 170, the stipulations in 16 U.S.C. § 1246(k) clearly are insufficient to satisfy the requirements of the charitable deduction statute. Although the implications of legislative grace and statutory construction may compel a disqualification of these deductions, such an outcome is contrary to the intent of the Trails Act.¹⁸⁸

¹⁸⁴ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2008).

¹⁸⁵ *Id.*

¹⁸⁶ As the Supreme Court stated in *New Colonial Ice Co., Inc. v. Helvering*, "The power to tax income . . . is plain and extends to the gross income. Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed." 292 U.S. 435, 440 (1934). See also *INDOPCO, Inc. v. Comm'r*, 503 U.S. 79, 84 (1992); *Comm'r v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974); *McDonald v. Comm'r*, 323 U.S. 57, 60 (1944); *Interstate Transit Lines v. Comm'r*, 319 U.S. 590, 593 (1943); *Deputy v. du Pont*, 308 U.S. 488, 493 (1940); *White v. United States*, 305 U.S. 281, 292 (1938).

¹⁸⁷ See *Kovner v. Comm'r*, 94 T.C. 893, 906 (1990); *Stark v. Comm'r*, 86 T.C. 243, 252 (1986); *Byrne v. Comm'r*, 65 T.C. 473, 479 (1975). All of the tax court cases rely, at least indirectly, upon *New Colonial Ice*, which clearly states that deductions are a matter of legislative grace but does not go so far as to expressly require a narrow construction. See 292 U.S. at 440.

¹⁸⁸ See H.R. REP. NO. 98-28, at 8 (1983), reprinted in 1983 U.S.C.C.A.N. 112, 119 (stating that subsection (k) was added to encourage conveyance).

Because 16 U.S.C. § 1246(k) specifically contemplates a charitable deduction for donations of property for use in the national trails system, then reading broad tax statutes as prohibiting the deduction seems to allow a general statute to prevail over a specific one. What's worse, nullifying through the partial interest rule the application of § 1246(k) to rail-trail conversions renders the major application of § 1246(k) moot, and courts might reasonably presume that Congress did not intend for such a consequence. Yet, it is important to note that § 1246(k) does not specifically state that donations of property interests for trail purposes should automatically qualify for charitable deductions or that railbanked corridors automatically qualify; instead, it simply creates the statutory safe harbor for I.R.C. § 170(h)(4).¹⁸⁹ To impute a meaning that is not present from the plain reading of an unambiguous statute might take statutory construction a step too far. Furthermore, 16 U.S.C. § 1246(k) is not aimed specifically at railroads, but rather at a general class of "landowners" who might feel compelled to donate their property.¹⁹⁰ Although the partial interest rule wipes out the major application of § 1246(k), it is entirely possible that the statute might be applied in other circumstances where the donor in question is not a railroad. As such, the statute is not wholly meaningless, and its failure to expressly provide the deduction probably renders it insufficient to overcome the strict application of the tax code.

If the tension in statutory construction was not enough, there is also the issue of legislative history. The legislative history of 16 U.S.C. § 1246(k) probably supports narrow application in view of I.R.C. § 170(h), yet ambiguous language contained in the legislative reports does little to resolve the debate. The House Report and the Senate Report contain identical language regarding the intent behind 16 U.S.C. § 1246(k).¹⁹¹ On the

¹⁸⁹ See 16 U.S.C. § 1246(k) (2000); I.R.C. § 170(h)(4).

¹⁹⁰ 16 U.S.C. § 1246(k).

¹⁹¹ The reports state as follows:

[Section 1246(k)] is added to encourage the donation and conveyance of land and easements by utilizing federal laws allowing for various tax benefits for such conveyances. This provision could be most advantageous in facilitating trail access and protection of rural landscapes in areas where the federal government is not actively involved in the acquisition of lands or the management of trails, and thereby encourages private sector initiatives in these endeavors. . . . This provision does not change existing tax law or regulations, but is intended to better define the types of interests in land that qualify under existing law when related to trail purposes. The Committee's intent is that easements donated pursuant to this provision shall have the same tax benefits to the donor as provided in [§ 170(h)].

one hand, the statute was not intended to “change existing tax law or regulations.”¹⁹² On the other, the intention was that the donors would have “the same tax benefits” as provided in I.R.C. § 170(h), and the reports stress Congress’s desire to encourage donation of property to the trails system.¹⁹³ We are left to wonder whether Congress intended for the railroad to have to pass through the technicalities of § 170(h) to avoid the partial interest rule, or whether it intended 16 U.S.C. § 1246(k) to pave a yellow-brick road. We are left wondering all the more in light of the fact that it was the Senate Committee on Energy and Natural Resources and the House Committee on Interior and Insular Affairs, not the Senate Finance Committee nor the House Ways and Means Committee, that drafted 16 U.S.C. § 1246(k) to interact with a rather technical provision of the I.R.C.¹⁹⁴

Regardless of congressional intent, if the railroads fail to qualify under I.R.C. § 170(h), the result could be a complete denial of the charitable deduction. As noted above, the partial interest rule is an all-or-nothing one—either the railroads may deduct the full fair market value of the donated property or they may deduct nothing.¹⁹⁵ As we discuss below, Congress could certainly amend 16 U.S.C. § 1246(k) or I.R.C. § 170(h) to resolve the tension between the two statutes.¹⁹⁶ In the absence of some kind of reconciliation, however, the statutory justification for the deduction seems weak at best. This leaves the railroads with the task of confronting the partial interest rule head on, rather than relying on the provisions for qualified conservation contributions in the NTSA. To do so, they must turn to the insubstantiality rule and the so-remote-as-to-be-negligible doctrine.

B. Application of the Insubstantiality Rule

The second argument the TAM addresses is whether the interest retained under the railbanking statute is insubstantial.¹⁹⁷ The railroads are unlikely to prevail on this basis for a number of reasons. First, a right to re-enter and reacquire uniquely situated and potentially valuable land

H. REP. NO. 98-28, at 8; S. REP. NO. 98-1, at 9 (1983).

¹⁹² H. REP. NO. 98-28, at 8.

¹⁹³ *Id.*

¹⁹⁴ *Id.* at 1; S. REP. NO. 98-1, at 1.

¹⁹⁵ See *supra* note 71 and accompanying text.

¹⁹⁶ See *infra* Part IV.

¹⁹⁷ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

at the donor's sole discretion and without cost is clearly a significant power. This right has significant value to the extent railroads fashion their railbanking and trail use agreements to allow them to determine when the market conditions favor reactivation and whether they have to pay to re-enter. Moreover, the right to determine or effectuate the forfeiture is often considered a more robust property right than an "incident of ownership." Although the railroads are somewhat at the whim of market forces, which certainly can dramatically limit their discretion, the interim trail user has virtually no power to deny a railroad the right to reclaim its corridor land. Even if the market conditions are unlikely to occur, the power to reclaim the land at will is clearly not insubstantial.

This fact is evident from a recent reactivation decision by the STB that sent shock waves throughout the rail-trail community when a railroad in Georgia sought to reactivate rail service and vacate the NITU that allowed for interim trail use.¹⁹⁸ The STB in that case addressed two important questions: 1) whether the railroad may reactivate on the line, and; 2) whether the interim trail sponsor was entitled to compensation as a precondition to the reactivation.¹⁹⁹ In answer to the first question, the STB explained that

an interim trail use arrangement is subject to being cut off at any time by the reinstitution of rail service. If and when the railroad wishes to restore rail service on all or part of the property, it has the right to do so, and the trail user must step aside.²⁰⁰

In addressing the second question, the trail sponsor argued that the railroad should have to pay compensation, in part because it had taken a charitable deduction when it donated the roadway.²⁰¹ The STB, without addressing the tax deduction portion of the trail sponsor's argument, denied compensation on the ground that its role in trail use agreements is purely ministerial, and that issues of compensation properly belong in the negotiations and contracts between the railroad and the trail

¹⁹⁸ Ga. Great S. Div., S.C. Cent. R.R. Co., Inc., *Abandonment & Discontinuance Exemption Between Albany & Dawson in Terrell, Lee, & Dawson Counties, Ga.*, Docket No. AB-389 (Sub-No. 1X), 2003 WL 21132515 (STB May 9, 2003). For an explanation of NITU and CITU, see *supra* note 20 and accompanying text.

¹⁹⁹ Ga. Great S. Div., 2003 WL 21132515, at *2-*4.

²⁰⁰ *Id.* at *3 (citing 16 U.S.C. § 1247(d); 49 C.F.R. § 1152.29(d)(2)-(3)).

²⁰¹ *Id.* at *4.

sponsor.²⁰² If the trail sponsor fails to insist on a right to compensation in the trail use agreement, the STB certainly will not imply one. This is true even if the trail sponsor has purchased the right-of-way from the railroad.²⁰³ Although the parties involved eventually negotiated to reactivate only a portion of the line, keeping the rest for a trail, the STB ruling is important. Many railroads and trail sponsors did not believe that reactivation was likely in many instances, so they did not provide for compensation or impose any restrictions on the railroads in the off chance they chose to reactivate. We believe it is safe to say that trail use agreements made after May, 2005 probably provide for compensation.

Nonetheless, the STB is the only entity that examines the appropriateness of rail service reactivation, and it has expressly stated that its role is ministerial:

No authority under [49 U.S.C. 10901] is required to reactivate rail service where, as here, the carrier who would have been the abandoning railroad had there not been rail banking and interim trail use, or its successor, is the one who decides to restore active rail service. Because it could have performed the operations without seeking any additional regulatory approval prior to the interim trail use, the resumption of service by the same carrier or its successor does not trigger the licensing requirement of section 10901, or require that its successor in interest seek concurrences from any other carrier.²⁰⁴

The utter lack of oversight means that the railroad has the full and sole discretion to decide whether to reactivate and trigger the re-entry provision. This power would clearly constitute a substantial retained interest.

In addition to there being no real oversight on the decision to reactivate, the only limitation on that power is economic and not legal. Although the railroads and trail sponsors have clearly negotiated their trail use agreements in the belief that there is little likelihood of reactivation, their subjective belief is not the issue. When the Supreme Court determined that the NTSA was a permissible exercise of interstate commerce in the *Preseault* decision, Justice Brennan rejected the adjacent

²⁰² *Id.* at *4-*5.

²⁰³ *Id.* at *5.

²⁰⁴ *Id.* at *3 (citation omitted).

landowner's argument that the right of re-entry is a sham.²⁰⁵ In noting that "Congress apparently believed that every line is a potentially valuable national asset that merits preservation even if no future rail use for it is currently foreseeable,"²⁰⁶ the Court found that rail corridor preservation was a valid legislative goal. It also held that the fact that "the ICC must certify that public convenience and necessity permit abandonment before granting a CITU or NITU does not indicate that the statute fails to promote its purpose of preserving rail corridors."²⁰⁷ Hence, the recognition of the importance of rail preservation in determining the constitutionality of the railbanking statute indicates that even if corridors are rarely reactivated, the power to do so is at the heart of the policy. We cannot ignore the central motivating logic behind the railbanking policy as though it is an insubstantial interest.

The importance of this re-entry right to the entire railbanking and rail preservation program means that even if the odds of reactivation are negligible, and the economic factors are outside the railroads' control, the property right itself is so central to the entire scheme that it simply cannot be considered insubstantial. Although few railroads have in fact reactivated,²⁰⁸ the right of re-entry is crucial to the rail preservation policy of the federal government.²⁰⁹ But it is in this sense that the insubstantiality rule and the so-remote-as-to-be-negligible doctrine diverge. The insubstantiality rule looks merely to the substance of the retained interest, ignoring the probability of divestment. It is precisely this probability, however, that factors into the so-remote-as-to-be-negligible doctrine, which does offer some hope to railroads seeking to navigate the pitfalls of the partial interest rule.

C. *Application of the So-Remote-as-to-be-Negligible Doctrine*

The third argument raised in the TAM concerns the so-remote-as-to-be-negligible doctrine and provides the greatest likelihood of success for the railroads under the current state of the law.²¹⁰ As the IRS stated in the TAM, it will consider four factors to determine whether the probability of a railroad exercising its right of re-entry to divest the interim trail user

²⁰⁵ Preseault v. ICC, 494 U.S. 1, 19 (1989).

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ See *supra* note 34.

²⁰⁹ H.R. REP. NO. 98-28, at 8 (1983).

²¹⁰ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

is so-remote-as-to-be-negligible.²¹¹ This argument is most beneficial to the railroads because the inquiry into each factor is highly fact dependent. In addressing each factor, we consider the factual scenarios as they generally exist and propose strategies that railroads might take to use each factor in its favor. By effectively understanding each factor, railroads can create more effective railbanking grants that bring to light the *bona fide* nature of the transactions.

1. The Intent of the Railroad and Interim Trail Sponsors

First, the IRS will attempt to ascertain whether, at the time of the donation, the donor and donee intend for the divesting event to occur.²¹² It is clear that in the vast majority of trail use agreements, there is no foreseeable intent to reactivate. This is supported by the fact that few trail sponsors thought to include a compensation element in the event that a railroad reactivates. Hence, the trail sponsor in the Georgia Great Souther Division Railroad reactivation in Georgia had to argue to the STB that it was entitled to compensation precisely because the parties had not included a better provision in their contract for how they would deal with a reactivation.²¹³ Not surprisingly, few trail use agreements before 2005 made adequate provisions for reactivation. Although on the one hand this seems to be manifestly contrary to common sense, it certainly did reflect the true belief of the parties that reactivation was unlikely, at least in the near future.

There is something rather perverse, however, in basing a charitable deduction on what is essentially bad legal drafting. And now that the STB has ruled that the railroad has the unilateral right to reactivate without consideration for the trail use agreement, trail sponsors from 2005 on have been diligent in including provisions for dealing with reactivation. The presence or absence of a compensation provision, however, should not be the determining factor in qualifying for the deduction. There should be some more uniform and rational understanding of the role of rail preservation and reactivation in the railbanking and interim trail use process. When the Preseaults argued before the Supreme court that the rail

²¹¹ *Id.*

²¹² *Id.*

²¹³ Ga. Great S. Div., S.C. Cent. R.R. Co., Inc., Abandonment & Discontinuance Exemption Between Albany & Dawson in Terrell, Lee, & Dawson Counties, Ga., Docket No. AB-389 (Sub-No. 1X), 2003 WL 21132515 (STB May 9, 2003).

preservation purpose was a sham, and that the underlying purpose of the railbanking statute was merely to create trails, the Court dismissed the argument under a relatively deferential statement that Congress could easily have intended both goals: new trails and rail preservation.²¹⁴ But underlying the Preseaults' argument is the fact that they are ultimately contradictory goals to the extent that a trail has to give way if a rail line is to be reactivated.²¹⁵ Of course, temporary trails are better than nothing: Congress accomplishes both goals to the extent that the railbanking statute allows interim trail use while preserving the corridor.²¹⁶ In light of the power to reactivate and potentially destroy the trail, however, the long-term policy is clearly to preserve transportation infrastructure, which is arguably not an environmental or conservation purpose and thus may not be charitable.²¹⁷

So what is the intent of the parties and, more importantly, how is that intent evaluated? In the context of the charitable deduction, the law remains ambiguous as to whether the subjective or objective intent of the parties controls in determining the validity of the contribution.²¹⁸ Nonetheless, there has been a recent trend toward a more objective approach.²¹⁹

²¹⁴ Preseault v. ICC, 494 U.S. 1, 19 (1989).

²¹⁵ For an example of how these two goals can coexist, see *infra* Part III.C.3 (discussing "rails with trails").

²¹⁶ See 16 U.S.C. § 1246(k) (2000).

²¹⁷ See I.R.C. § 170(h) (requiring that deductions be made for charitable purposes and serve a conservation goal).

²¹⁸ The tax law definition of a gift as that coming from "detached and disinterested generosity" originated in *Duberstein v. Comm'r*, 363 U.S. 278, 285 (1960) in regards to I.R.C. § 102. Courts have struggled in applying this standard as either a subjective or objective test in regards to I.R.C. § 170. For cases that seem to apply a subjective test, see *Winters v. Comm'r*, 468 F.2d 778 (2d Cir. 1972); *DeJong v. Comm'r*, 309 F.2d 373, 377-78 (9th Cir. 1962). For cases that seem to apply an objective test, see *Christiansen v. Comm'r*, 843 F.2d 418, 420 (10th Cir. 1988); *Miller v. IRS*, 829 F.2d 500, 502 (4th Cir. 1987); *Graham v. Comm'r*, 822 F.2d 844, 848 (9th Cir. 1987); *Oppewal v. United States*, 468 F.2d 1000, 1002 (1st Cir. 1972); *Singer Co. v. United States*, 449 F.2d 413, 423 (Ct. Cl. 1971). In its most recent opinion on the issue, the Supreme Court seems to have skirted the issue. See *Hernandez v. Comm'r*, 490 U.S. 680 (1989) (determining deduction on basis of *quid pro quo*); Douglas A. Kahn & Jeffrey H. Kahn, "Gifts, Gifts, and Gifts"—*The Income Tax Definition and Treatment of Private and Charitable "Gifts" and a Principled Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 496-512 (2003).

²¹⁹ See *supra* note 218. This fact is also supported by the enactment of I.R.C. § 170(f)(8) under the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13173(a), 107 Stat. 312, 456. This section sets forth substantiation requirements for any contribution in excess of \$250, which direct the charitable organization to provide an acknowledgment of the amount of cash and a description of the property received, whether the donee provided

Thus, while it is clear that the actual subjective intent of the parties in the overwhelming number of cases is that there is no likelihood of reactivation, we are left to inquire into what a more objective intent would be between parties who are presumed to know at the outset what the eventual outcome *could* be. In this sense, an objective approach asks what a reasonable railroad and trail sponsor would likely intend if they knew that reactivation was going to occur. If reactivation were looming large over the transaction, the trail use agreement would most likely contain a compensation element, because no trail sponsor wants to spend millions of dollars converting an old railroad bed into a recreational trail only to have it all torn up and reconverted to rails a few years after it opened.²²⁰

Accordingly, because a railroad's obligation to compensate interim trail users in the event of reactivation would be the likely intent of the parties, the right to re-enter would become more costly and reactivation would be less likely to occur. This may seem like a rather convoluted way to deal with what should be a relatively straightforward issue, but it once again shows how the tension between the trail use and the rail preservation goals collide. Railroads should meet the intent element, whether the IRS adopts an objective or subjective intent standard: either the parties did not form the subjective intent to reactivate, or, had they objectively thought about it, they would have included a compensation element which would naturally decrease the likelihood that reactivation would occur.

Additionally, railbanking agreements should expressly state the parties' intent to make a *bona fide* charitable contribution while still preserving the potential for reactivation in relatively narrow circumstances. Stating the narrow circumstances that would motivate a railroad to reactivate will demonstrate that in the overwhelming number of circumstances, interim trail use, corridor preservation, and charitable intent can coexist.²²¹

any goods or services in return, and a good faith estimate of any goods or services if so provided. I.R.C. § 170(f)(8). Although this statute speaks more to valuation, congressional intent seems to favor a more objective evaluation. See Kahn & Kahn, *supra* note 218, at 510.

²²⁰ See generally KAREN-LEE RYAN & JULIE WINTERICH, RAILS-TO-TAILS CONSERVANCY & NAT'L PARK SERV., SECRETS OF SUCCESSFUL RAIL-TRAILS: AN ACQUISITION AND ORGANIZING MANUAL FOR CONVERTING RAILS INTO TRAILS, available at http://www.railtrails.org/resources/documents/resource_docs/tgc_secrets.pdf (discussing the extensive financial resources and planning needed to build a rail-trail).

²²¹ Furthermore, including the narrow circumstances under which the railroad might reactivate as conditions precedent in the agreement reduces the likelihood of reactivation and provides independent considerations that diminish the ability of the railroad to act unilaterally. Drafting in this manner is important, as discussed *infra* Part IV.

Thus, regardless of whether a compensation element is included in the trail use agreements, better drafting of the intent element should place the transaction on the more remote side of the spectrum.

2. The Incidence of Past Reactivation

Under the second factor, the IRS will consider the incidence of the divesting event having occurred in the past.²²² As noted above, only five railroads have sought to reactivate after railbanking their corridors.²²³ The total mileage of those five is less than two percent of the sum total of miles in the rail bank.²²⁴ Despite the infrequency, railroads and the IRS would do well to recognize that certain factors might lead to a greater likelihood of reactivation, though we feel that no factor seems to be conclusive. One could reasonably argue that nearly any corridor along the heavily-trafficked Washington, DC-Boston corridor is a likely culprit for reactivation. As population and automobile pressures increase and the finite amount of land prevents building new roads, the attractiveness of reactivating rail lines may increase. Similarly, planners in some of the high-growth areas of the country around rapidly expanding urban areas (Phoenix, San Diego, Houston, Atlanta) may eye discontinued rail corridors as new avenues to open commuter rail lines.²²⁵

As of yet, however, the corridors that have been reactivated are not in heavily trafficked areas. The first reactivation concerned reconstruction of a 1.8 mile segment of an abandoned corridor in Council Bluffs, Iowa to provide a more direct route for hauling coal to the Iowa Power Council Bluffs Energy Center.²²⁶ The second reactivation involved a 9.1 mile corridor between St. Mary's and Minster, in rural Auglaize County, Ohio.²²⁷

²²² I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

²²³ See *supra* note 34.

²²⁴ Fewer than 80 miles of railbanked corridor have had their NITU/CITU vacated for reactivation out of a total of 4,431 miles in the railbank. See *infra* notes 226-235; Rails-to-Trails Conservancy, What is Railbanking?, <http://www.railtrails.org/whatwedo/trailadvocacy/railbanking.html> (last visited Mar. 25, 2008); National Trails Training Partnership, Reactivated Railbanked Corridors: Rail Trails Returned to Railroad Service, <http://www.americantrails.org/resources/railtrails/rerail04.html> (last visited Mar. 25, 2008) (summarizing the reasons for each reactivation).

²²⁵ See John Spsychalski, *Rail Transport: Retreat and Resurgence*, 553 ANNALS AM. ACAD. POL. & SOC. SCI. 42, 50 (1997).

²²⁶ Iowa Power, Inc., Constr. Exemption in Council Bluffs, Iowa, 8 I.C.C.2d 858 (1990).

²²⁷ Norfolk & Western Ry. Co., Abandonment Between St. Marys & Minister in Auglaize County, Ohio, 9 I.C.C.2d 1015 (1993).

In that case, the STB explained that a rail carrier that banks its corridor has retained "its common carrier obligation."²²⁸ The Board explained:

By consenting to the issuance of a CITU/NITU, a carrier agrees to forgo consummating the authorized or exempted abandonment. As a consequence, its common carrier obligation does not terminate. Instead, the abandoning carrier retains a residual common carrier obligation and transfers the right-of-way to the trail user, subject to the stipulation that the rail corridor remain available for the reinstitution of rail service. . . .

The right to reinstitute rail service is a common carrier interest that did not exist prior to the Trails Act. Notwithstanding any understanding or agreement between the abandoning carrier and the trail user, this right does not transfer to the trail user without our explicit approval.²²⁹

The language of the STB in this case indicates that the continuation of the common carrier duties is the legal obligation retained by the railroads, and that the ability to meet that obligation on the transferred corridor is a mere corollary to that obligation.

The third reactivation involved only 1100 feet of a Union Pacific corridor to allow it to extend track to an active shipper.²³⁰ Union Pacific claimed that it needed the additional track beyond its current switch "to allow for adequate 'tail' room to spot rail cars at the shipper's facilities."²³¹ This 1100 feet was located in the metropolitan St. Louis area but was closely connected to an already active Union Pacific line.²³² The fourth reactivation, the Georgia Great Southern Division Railroad line, was for 13.62 miles between Albany and Sasser, Georgia.²³³ The motivation for the reactivation was that the Georgia Southwestern Railroad had to use trackage rights of Norfolk Southern, which it claimed was financially

²²⁸ *Id.* at 1018.

²²⁹ *Id.* (citations omitted).

²³⁰ *Mo. Pac. R.R. Co., Abandonment Exemption in St. Louis County, Mo.*, Docket No. AB-3 (Sub-No. 98X), 1997 WL 201480 (STB Apr. 18, 1997).

²³¹ *Id.*

²³² *Id.*

²³³ *Ga. Great S. Div., S.C. Cent. R.R. Co., Inc., Abandonment & Discontinuance Exemption Between Albany & Dawson in Terrell, Lee, & Dawson Counties, Ga.*, Docket No. AB-389 (Sub-No. 1X), 2003 WL 21132515 (STB May 9, 2003).

detrimental and inefficient.²³⁴ The final reactivation involved a 52 mile rural corridor between Spalding and Grangeville, Idaho where the railroad asserted there were two major grain shippers interested in reactivating the corridor for use during peak grain traffic season.²³⁵

What these diverse reactivations indicate is that less than two percent of the total railbanked mileage has been reactivated in twenty years of railbanking. Notably, some of the most profitable land (that in urban corridors) is not what is being reactivated. Some reactivations may be motivated by anti-trail animus and reactivators may exaggerate the demands of shippers in order to defeat a potential trail. The Georgia line shows what happens when railroads abandon lines thinking they can use trackage rights of other carriers and then find their trains at the end of the waiting list for access to rail yards. The St. Louis and Council Bluffs reactivations were for very limited industrial uses that involved relatively short segments of corridor. Thus, it is difficult to make any general statements about the types of corridors that are most likely to be reactivated. One can generalize, however, that if a railroad has to compensate the trail owner for the value of the corridor when it does choose to reactivate, that the more expensive urban routes will be reactivated only when the economic conditions justify the expensive rehabilitation.

Looking at other factors that might tend to increase the likelihood of reactivation appears to be fruitless. Although one would think that urban areas are more likely to be reactivated because of heavier traffic (both rail and automobile), the majority of the actual reactivations were in rural areas.²³⁶ One might suppose that areas involving heavy grain production or coal production, products that are usually shipped on railroads, would be more likely to see reactivations. However, those areas have actually seen fewer abandonments precisely because those shippers have continuously been using rail services.²³⁷ It seems logical that the places most likely to see reactivations are rapidly growing urban areas that saw interconnected highways and interstates displace passenger rails with the rise of the suburban automobile commuter. However, railbanking pursuant to STB procedures only applies to corridors used for freight rail lines,

²³⁴ *Id.* at *2.

²³⁵ BG & CM R.R., Inc., Exemption from 49 U.S.C. Subtitle IV, Finance Docket No. 34399, 2003 WL 22379168 (STB Oct. 17, 2003).

²³⁶ See *supra* note 224.

²³⁷ See Spsychalski, *supra* note 225, at 52 (noting that the government made a great effort to keep railways running where they were "considered indispensable by coal, automotive, steel, chemical, lumber, and grain shippers").

so former passenger rail lines are unavailable.²³⁸ Thus, most of those lines have already been lost and would require eminent domain or voluntary sales to reestablish them.

The lines that were abandoned in the late 1980s and 1990s, and were hence available for railbanking, tended to be duplicate shipping lines that were consolidated with the breakup of Conrail, whose assets were transferred to CSX and Norfolk Southern,²³⁹ or were the result of consolidations and mergers by companies like Burlington Northern and Union Pacific.²⁴⁰ These latter railroad giants were swallowing up smaller lines throughout the 1970s and 1980s to eliminate costly competition, and then they shed unprofitable or duplicative lines.²⁴¹ Even smaller lines, like the Camas Prairie RailNet, that resisted consolidation with the major western carriers found that they could not compete with the main lines and simply faded away.²⁴² With the current national rail system relatively sleek and efficient, limited to a handful of major carriers, the rate of abandonments has decreased,²⁴³ indicating that we are unlikely to see a significant increase in the railbank. However, the slimness of the system means that we may see more reactivations as transportation pressures increase.²⁴⁴

It remains difficult to articulate any generalized rules to predict when reactivation is likely to occur. Although empirical analysis demonstrates a greater likelihood of rural reactivation, theoretical predictions based upon economics and population growth indicate that future reactivation would be more likely to occur in urban areas. Irrespective of geographic location, railroads should safely rely upon, and the IRS should recognize, the statistical realities underlying these transactions. With

²³⁸ See 49 U.S.C. § 10501 (2000).

²³⁹ Bruce Ingersoll, *U.S. Approves Plan to Divide Conrail in Two*, WALL ST. J., June 9, 1998, at A3.

²⁴⁰ BNSF Railway, BNSF History, <http://www.bnsf.com/aboutbnsf/history/index.html> (last visited Mar. 25, 2008); Union Pacific, Chronological History, <http://www.uprr.com/aboutup/history/uprr-chr.shtml> (last visited Mar. 25, 2008).

²⁴¹ Spychalski, *supra* note 225, at 53 (noting that revenue increased while miles of line owned decreased between 1980 and 1995).

²⁴² See Kansas Rail Users Group, *Watco and RailNet Announce Agreement for Sale of Camas Prairie RailNet*, DEPOT NEWS, Feb. 17, 2004, <http://www.depotnews.com/KRUG/040217KRUGa.htm>.

²⁴³ See SURFACE TRANSP. BD., ANNUAL REPORT 1996-1997, at 15 (1998); SURFACE TRANSP. BD., ANNUAL REPORT 1998-2001, at 25 (2002); SURFACE TRANSP. BD., ANNUAL REPORT 2002-2004, at 26 (2005), available at <http://www.stb.dot.gov/stb/about/annual.html>.

²⁴⁴ Although only the abandoning railroad has the right to reactivate, STB procedures allow any other railroad the right to petition, through an offer of financial assistance, to step into the shoes of the abandoning railroad and acquire its rights to operate.

fewer than two percent of railbanked mileage reactivated over the last twenty years, the probability statistically lies well below the five-percent threshold, rendering the likelihood of reactivation so remote as to be negligible. And to this point we must add that as the use of railbanked corridors for recreational purposes becomes more widespread, the public outcry that would accompany destruction of a popular trail may also reduce the likelihood of reactivation.²⁴⁵

3. The Extent to which Reactivation Defeats Trail Use

Third, the IRS determines the extent to which the divesting event would defeat the donations.²⁴⁶ This is, in essence, an inquiry into whether the charity is deprived of the benefit of the contribution upon the exercise of re-entry. Although in some instances reactivation might entirely eradicate any interest that the interim trail user possesses, this is not always the case. Based on a recent trend, railroads might engage in “rails *with* trails” upon reactivation.²⁴⁷ And as mentioned above, railroads must consider the public response to reactivation as part of their calculation of the benefits and costs of resuming rail services. Once an interim trail has been established on a corridor, the public outcry over destruction of the trail is another disincentive for reactivation. Popular routes, like the Katy Trail in Missouri and the Cowboy Trail in Nebraska,²⁴⁸ would be staunchly defended if the railroads sought to reactivate. Even more likely, the popularity of the route would hopefully encourage negotiations over alternatives that would allow the trails to remain while limited rail service was reactivated.²⁴⁹ The State of Indiana recently amended its statutes that had

²⁴⁵ Patrick Blais, *Funding for Path in Danger*, THE STONEHAM INDEPENDENT (Mass.), Aug. 6, 2003, available at <http://www.stonehamindependent.com/archives/2003/08/06/2> (noting the widespread public outcry to the reduction in federal financial support for rail-trails).

²⁴⁶ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

²⁴⁷ See RAILS-TO-TRAILS CONSERVANCY, RAILS WITH TRAILS (2000) [hereinafter RAILS WITH TRAILS], available at http://www.railtrails.org/resources/documents/resource_docs/Rails-with-Trails%20Report%20reprint_1-06-1r.pdf.

²⁴⁸ For more information about these trails, see About Katy Trail State Park, MO, <http://www.bikekatytrail.com> (last visited Mar. 25, 2008); NEBRASKA GAME AND PARKS COMMISSION, COWBOY RECREATION AND NATURE TRAIL 2 (2006), available at <http://www.ngpc.state.ne.us/parks/pdfs/cowboytrail.pdf>.

²⁴⁹ See RAILS WITH TRAILS, *supra* note 247, at 12-15 (describing five successful rails with trails arrangements).

once forbidden rails with trails to permit them in certain circumstances.²⁵⁰ This would mean that even if the railroad reactivated, the public purpose behind the donation would remain viable as the conservation of open lands and provision of trails could continue.

In most states, the issue of rails with trails is left to regulatory agencies to determine the viability of any project on a case-by-case basis. Notable among the considerations that such agencies make is the fact that a one-hundred-foot corridor can easily accommodate one or two tracks (four feet, eight and one-half inches being standard gauge)²⁵¹ and still leave half of the corridor for a ten-foot trail and appropriate buffer vegetation. Even if rail service is reinstated, therefore, at least some of the conservation and trail benefits will remain. There are currently hundreds of miles of rails with trails and the incidence of accidents is virtually nil.²⁵² Thus, as with the other two factors noted above, the small likelihood of reactivation and the possibility of harmonious mixed use supports the applicability of the so-remote-as-to-be-negligible exception.

4. Railroads' Control over the Right of Re-entry

The final and most problematic consideration is the extent to which the donor controls the divesting event.²⁵³ In most current trail use agreements, the railroads are the sole decisionmakers regarding whether they will re-enter and reactivate. The STB has placed some limits on that right, however. First, only the originally abandoning railroad has the common carrier obligation to resume rail service, and therefore only the reactivating railroad or another railroad authorized by the donor railroad has the right to re-enter.²⁵⁴ This means that if a railroad does not want to reactivate itself, it can keep a competitor from doing so on its old roadbed, at least until an intervening agency determines that the public convenience and necessity demand reactivation. Although that power is not insignificant, it does limit the possible parties likely to reactivate. The limited pool of railroads entitled to re-activate will necessarily limit the likelihood of reactivation.

²⁵⁰ 1999 Ind. Legis. Serv. 158, § 15 (codified at IND. CODE ANN. § 8-4.5-6-1(c)).

²⁵¹ Douglas Puffert, *The Standardization of Track Gauge on North American Railways, 1830-1890*, 60 J. ECON. HIST. 933, 933 (2000).

²⁵² RAILS WITH TRAILS, *supra* note 247, at 5-6.

²⁵³ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

²⁵⁴ Norfolk & Western Ry. Co., Abandonment Between St. Marys & Minister in Auglaize County, Ohio, 9 I.C.C.2d 1015, 1018-19 (1993).

Trail sponsors that had the foresight to place a compensation duty on railroads wishing to reactivate will have established a disincentive that may be enough to deter a railroad from reinstating rail services. But ultimately, the decision to reactivate is in the hands of the railroad and it will make its decision based on the market forces and economic circumstances of the time.²⁵⁵ The STB must vacate the NITU/CITU, however, before reactivation will be allowed, and although the STB has stated that its oversight is somewhat limited, the Board did note that a NITU/CITU will be vacated under only two circumstances: when the trail user requests the vacation or when an application to construct and operate a rail line is granted under 49 U.S.C. § 10901.²⁵⁶ The latter requires that reactivation be in the public interest. Section 10901(c) states:

The Board shall issue a certificate authorizing activities for which such authority is requested in an application filed under subsection (b) unless the Board finds that such activities are inconsistent with the public convenience and necessity. Such certificate may approve the application as filed, or with modifications, and may require compliance with conditions (other than labor protection conditions) the Board finds necessary in the public interest.²⁵⁷

Even this modest oversight provides some check against railroads unilaterally deciding to exercise their reactivation rights, and it could prove meaningful in the case of a popular public trail that provides health and recreational resources to thousands of people that is at risk of closure by a railroad seeking reactivation to service a single shipper. Although rail preservation and future reactivation are deemed superior rights to the interim trail use, it is not entirely clear that all reactivations will be in the public interest.²⁵⁸

Nonetheless, the donor's ability to defeat the interest is clearly the strongest argument for the IRS in denying the deduction. The current public interest test is a weak challenge to the railroads' power. Yet, railroads can potentially minimize this element through careful drafting. The railroad could allow trail groups to negotiate for tougher standards

²⁵⁵ See National Trails Training Partnership, *supra* note 224 (describing the reasons for the five reactivations).

²⁵⁶ *Norfolk & Western Ry. Co.*, 9 I.C.C.2d at 1016-17.

²⁵⁷ 49 U.S.C. § 10901(c) (2000).

²⁵⁸ See *id.*

in the railbanking grants so that reactivation would occur only upon a greater showing of public necessity. Although the railroads are free to structure the agreements so that they retain the right to re-enter conditioned exclusively upon their will to do so, they are also free to create more robust prerequisites to reactivation. In fact, many of these prerequisites are already implicit in the business decision to reactivate, so placing such restrictions in an agreement merely gives legal effect to considerations that already weigh into the decision.²⁵⁹ More importantly, placing the restriction in the gift agreements will, so far as the IRS may be concerned, increase the remoteness of the contingency. By subjecting the railroads to ascertainable standards that serve as prerequisites to reactivation, the fourth factor can be turned in favor of the railroads that are prohibited from reactivating corridors simply when their sole discretion supports such a decision. There are several restrictions that the railroads could place in the gift agreements to effectuate such restraints, such as meeting certain market conditions, giving evidence of technological developments that mandate reactivation, or even making the right to re-enter require compensation for significant value.

IV. LEGISLATIVE AND ADMINISTRATIVE POLICYMAKING IN THE PUBLIC INTEREST

Irrespective of the railroads' ability to structure their donations in a manner that tips the balance of the factors below the five percent threshold, one cannot help but recognize that the heart of the problem truly lies with two competing public policies. The NTSA promotes health and recreational activity, environmental conservation, and alternative transportation venues.²⁶⁰ It also preserves valuable stretches of rail corridors that took decades to assemble.²⁶¹ The need for such corridors may have declined with the popularity of rail transportation, but these corridors remain a valuable national asset.²⁶² Potential future uses support keeping this unique assemblage of property intact. The economic benefit of this potential value, however, remains with the railroads and their reversionary interest, notwithstanding the fact that the retention of this interest is not

²⁵⁹ See National Trails Training Partnership, *supra* note 224 (describing the reasons for the five reactivations).

²⁶⁰ National Trails System Act, Pub. L. No. 90-543, § 2(a), 82 Stat. 919, 919 (1983).

²⁶¹ See *Preseault v. ICC*, 494 U.S. 1, 19 (1989).

²⁶² *Id.*

entirely by choice.²⁶³ As such, the policy of ensuring that a taxpayer does not receive a charitable deduction for the value of property to which the taxpayer might become wholly re-entitled cannot be overlooked. But if the fear is that taxpayers, in this case the railroads, will abuse the charitable deduction by having their cake and eating it too, it seems counter-intuitive to place the availability of the deduction in an amorphous rule that the railroads can bend in their favor. On a higher level, it seems fundamentally undemocratic to leave the resolution of conflicting policy objectives in the hands of a private party. Instead, legislative and administrative steps should be taken to reconcile the partial interest rule and the railbanking statute.

The most obvious solution is the legislative one—Congress should amend the law. Although this relatively technical imprecision in the law is unlikely to attract broad congressional interest, two options are available. First, Congress could amend 16 U.S.C. § 1246(k) to take the additional step that it arguably failed to take the first time. This would require legislation that would deem I.R.C. § 170(h)(2) satisfied in cases of contributions of railbanked property to the trails system by explicitly discounting the possibility of future rail use in the conservation purpose calculation. This would create the safe harbor for all donations of railbanked properties regardless of the likelihood of reactivation. Second, and more directly, Congress could amend § 170(h)(2) to include as a qualified real property interest the transfer of a railbanked corridor under the railbanking statute. Either of these solutions would afford to the railroads the deduction, but would perhaps provide an incentive to abuse the process absent federal oversight.

Concern that a railroad might donate a corridor and claim the deduction only to reactivate a short time later might also be addressed statutorily. Several solutions exist. Congress could require that to be eligible for a charitable deduction, any railbanking grant must include a requirement that the trail manager is not compelled to return the corridor unless the railroad pays current fair market value compensation to the interim trail user as a prerequisite to reactivation. Additionally, Congress could set forth more stringent conditions precedent to reactivation. There is no reason to think that making it harder for the railroad to reactivate will undermine the rail preservation goals of the railbanking laws, so long as the terms of reactivation comport with the economic decisions the

²⁶³ The railbanking regulations require that a railroad wanting to railbank must keep this interest. See *supra* note 55.

railroads face anyway. Thus, by building into the analysis a thoughtful determination of the public interest, the STB can at least prevent the vacating of NITUs and CITUs by sham entities hoping to shut down popular trails by claiming they will reinstate rail service. It will also prevent real estate companies that obtained NITUs and CITUs with no intention of constructing a trail from using the process as a holding mechanism to market land to adjacent landowners.²⁶⁴

By imposing greater statutory criteria for reactivation, the interim trail user would be far less vulnerable to the caprice of the railroads. If reactivation could occur only when economic, sociological, and political factors support such reactivation, and there was some administrative oversight in the determination of these factors, the ability of the railroads to game the system would significantly decrease. Finally, and perhaps to the chagrin of the tax code's general aversion to playing leap frog among tax years, we see nothing wrong with forcing a railroad to include in income the value of a previously taken deduction in the event that the railroad reactivates.²⁶⁵ This would successfully eliminate any windfall gain to the railroad upon reactivation and would perhaps even lend an additional incentive to railbank.

Many of these regulatory steps might arise with greater ease through administrative regulation, either by the promulgation of treasury regulations by the IRS or through STB regulations that provide more than ministerial oversight in the railbanking and reactivation process. To the extent these measures can be taken administratively, the IRS and the STB should act. More importantly, though perhaps idealistically, we encourage greater cooperation between the IRS, the STB, and the National Parks Service on this issue. If these groups worked together to devise more cogent policies to encourage both the trail use and rail preservation goals while offering fair and rational tax incentives, the tension between these important policies would be resolved by the public agencies charged with promoting them, and not by the self-serving actions of private parties seeking to maximize their economic positions.

Even if the regulatory agencies do not work together to make the dual goals of the railbanking statute more rational in light of the

²⁶⁴ See *Tulare Valley R.R. Co., Abandonment & Discontinuance Exemption in Tulare & Fresno Counties, Cal.*, Docket No. 397 (Sub.-No. 3X), 1996 WL 453238 (STB Aug. 13, 1996).

²⁶⁵ This concept already exists elsewhere in the I.R.C. See I.R.C. §§ 179(d)(10), 280F(b)(2) (requiring "recapture" of income where certain property is converted from business to non-business use).

permissible tax deductions, they could certainly articulate rules and standards within their own agencies that would help further the important goals of the railbanking law. While the TAM²⁶⁶ was a step in the right direction, the IRS could go further. Two steps would be relevant to all forms of charitable giving. First, a revenue ruling or treasury regulation extending the five percent standard to I.R.C. § 170 would be of primary importance. Second, these same media could be utilized to promulgate a more coherently defined set of factors that taxpayers can use to evaluate whether a contingency is so remote as to negligible. If this issue arises on the magnitude that we anticipate, a revenue ruling providing guidance specifically to the railroads on when a particular railbanking donation will be disallowed would provide the additional certainty necessary to promote this important conservation purpose. At the same time, the STB could impose more substantial criteria for determining the public convenience and necessity that goes into rail reactivation. It could also pursue more informal avenues, such as educating railroads and interim trails users before these parties enter into their railbanking agreements as to the factors that the IRS will consider.

Although these agency actions may seem unlikely, and perhaps even undesirable for the railroads, it is the public agencies that are charged with promoting rational rules to further important legislative policies. Consequently, these groups, rather than the private railroads, should be initiating any changes that might help resolve the conflicts discussed herein. It would seem particularly true that public agencies are more likely to make regulatory decisions with an eye toward the public interest than private corporations seeking to maximize their bottom lines.²⁶⁷ Thus, it would seem eminently logical for the IRS to make rules about the scope of the deduction before it has to litigate the issue with irate taxpayers. But even if this is too optimistic, we hope that such a thorough understanding of the conflict, as we have articulated in this Article, will enable all the parties to work toward an acceptable solution. If railroads and trail sponsors will draft better agreements, they can help foster the important public policies behind all of these laws.

Finally, we must offer a final caveat. The correct solution is not for the railroads and trail sponsors to enter into an agreement by which

²⁶⁶ I.R.S. Tech. Adv. Mem. 06-10-017 (Mar. 10, 2006).

²⁶⁷ See Jody Freeman, *Extending Public Law Norms Through Privatization*, 116 HARV. L. REV. 1285, 1303-04 (2003). But see Abner Mikva, *Foreword*, 74 VA. L. REV. 167, 168-69 (1988).

the railroad agrees not to exercise its right to reactivate. Such an agreement undermines the rail preservation policy of the railbanking statute by making it a mere shibboleth. If the tension between these policies and regulations ultimately leads to the obliteration of the right to reactivate, the legal foundation of the railbanking process will crumble. Until the laws of the states are better formed to permit a broad shifting public use doctrine, which would allow the conversion of rail corridors to other public uses, the railbanking statute is the only mechanism for preserving these national assets. We cannot allow the Preseaults' claim that the rail preservation goal is a sham to become real. If we do, we will have lost sight of the public interest and the public character of these quasi-public spaces.

CONCLUSION

Although many people probably do not appreciate the complex legal issues involved in recycling unused railroad corridors into recreational trails, most would approve of using tax incentives to encourage railroads to donate their corridors for public uses. These corridors were assembled with extensive public aid, from eminent domain powers to state and federal gifts of land.²⁶⁸ Even private grantors often donated the land to the railroads if they would locate a depot or freight-loading station nearby.²⁶⁹ The railroads have common carrier obligations and are federally regulated because of their great public importance.²⁷⁰ And the NTSA amendments that created the railbanking program have proven to be critical in preserving thousands of miles of priceless rail corridors.²⁷¹ Trail users, municipal governments and local parks departments, and even the railroads are coming together to facilitate the dual goals of the railbanking statute: interim trail use and rail preservation. And there are many good reasons for the railroads to participate besides the prospect of a valuable tax deduction. But as with many provisions in the I.R.C., tax deductions can provide a powerful incentive for private parties to take actions that benefit the public at large. Thus, there is a trade-off between the revenue consequences and the public benefits that accrue from charitable giving.

²⁶⁸ Wright & Hester, *supra* note 10, at 368-72 (describing the complicated process by which railroads assembled corridors).

²⁶⁹ POWELL, *supra* note 4, § 78A.06[1].

²⁷⁰ See *Norfolk & Western Ry. Co., Abandonment Between St. Marys & Minister in Auglaize County, Ohio*, 9 I.C.C.2d 1015 (1993).

²⁷¹ See *Rails-to-Trails Conservancy, What is Railbanking?*, <http://www.railstotrails.org/whatwedo/trailadvocacy/railbanking.html> (last visited Mar. 25, 2008).

We have shown in this Article how railbanking, interim trail use, and charitable giving policies may clash when rail-trail conversions encounter the partial interest rule. And we have offered some partial solutions for rationalizing the intersection of the I.R.C. and the NTSA in the context of railbanking. In the end, however, we strongly urge the IRS, the STB, the National Parks Service and the railroads to work together to create a regulatory mechanism that will foster, as best it can, the dual goals of rail preservation and interim trail use. For with each mile of railroad corridor that is irrevocably lost, the public loses an important transportation option, the value of which may not be fully appreciated until it is gone. Harmonizing our laws to recognize the public aspects of railroad corridors, to preserve them for future generations, and to respect the private rights of landowners and railroads is no easy task. We hope that this analysis will help move us toward a less conflicting set of transportation, conservation, and economic policies that will preserve rail corridors for future generations.